THE INTERNATIONAL MONETARY FUND

HEARING

BEFORE THE

SUBCOMMITTEE ON
INTERNATIONAL DEVELOPMENT, FINANCE, TRADE AND MONETARY POLICY

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

APRIL 19, 1994

Printed for the use of the Committee on Banking, Finance and Urban Affairs

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THE INTERNATIONAL MONETARY FUND

TUESDAY, APRIL 19, 1994

House of Representatives,
Subcommittee on International Development,
Finance, Trade and Monetary Policy,
Committee on Banking, Finance and Urban Affairs,
Washington, DC.

The subcommittee met, pursuant to call, at 10:03 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the subcommittee] presiding.

Present: Chairman Frank, Representatives LaFalce, Kennedy, Waters, Watt, Fingerhut, Bereuter, McCandless, Johnson, and Nussle.

Chairman Frank. The hearing will begin.

This is a hearing of the Subcommittee on International Development, Finance, Trade and Monetary Policy on the question of the authorization of an American contribution to the Enhanced Structural Adjustment Facility of the IMF.

The subcommittee has dealt with the World Bank and some of the regional multilateral development banks. I believe this is the subcommittee's first hearing in this Congress on the IMF. Obviously, the role of the IMF has become increasingly important and presents some very significant policy issues. And while, as I have had the occasion to note from time to time, the issue before us is whether or not we will authorize the U.S. contribution and we do not, as a Congress, have authority to legislate about the IMF, it is a well-known principle of legislation that the ankle bone is connected to the shoulder bone. Therefore, what the IMF is or is not doing or what they should or shouldn't be doing will inevitably, though not legally or formally, have an effect on the ability of this subcommittee to successfully put forward an authorization.

So we address this in terms of the concerns that people have about IMF policy in general, and the more satisfaction that exists within the Congress with the policies of the IMF, the more likely we are to be able to get the legally unrelated authorization passed into law.

And I will now recognize the ranking minority Member.

Mr. Bereuter. Thank you very much, Mr. Chairman. I look forward to the testimony of the witnesses.

I do not have a prepared opening statement, but I will say by way of explanation that the State Department authorization conference begins right now, and I am a conferee. If I leave abruptly, it is only because of that, and I will be back as soon as possible.

Chairman Frank. Other statements?

Mr. LaFalce. Mr. McCandless, any other opening statements?

Mr. McCandless. No, Mr. Chairman.

Chairman Frank. Mr. Kennedy.

Mr. Kennedy. Yes, I have a brief opening statement, Mr. Chairman.

Mr. Chairman, first of all, I want to thank you very much for holding this hearing. I think this is a very, very important issue that many people around the country are simply unaware of, as you and other members of this subcommittee have been following structural adjustment lending and have seen its progress over the course of the last 8 years or so; and it is an issue that I think should be discussed in a great deal more oversight than has taken place.

One of the issues that I think we need to take a hard look at is the input of the local countries in terms of the process that the IMF imposes on that nation. It seems to me that having some independent judgment, one of the issues that I think has always taken place with structural adjustment lending is the very strict changes that this imposes upon the developing country that happens to be a recipient of the benefits. What we all then do is sort of have a very silent debate about the actual negotiation, and then everybody attends some kind of signing ceremony or cocktail party or something like that, when all of a sudden this agreement has been negotiated; and we have no idea of what has actually taken place or the devastation that might actually be taking place in the local nation while the Structural Adjustment Program is being negotiated.

I think that these are the kinds of programs where there ought to be a lot more open debate.

You have always, Mr. Chairman, been a very strong advocate of having open, strong, tough debates that people can have input and can have agreement or disagreement over. I don't see why the IMF should be so secretive in terms of their policies and processes.

So I look forward to hearing from our witnesses, but I am very interested in seeing some of those issues debated in a much more public fashion.

Chairman Frank. I thank the gentleman.

If he would yield, as you recall, last year, one of the things that we thought was important before we would be able to agree to an authorization for the International Development Association of the World Bank was a very major change in the information policy of the World Bank. The Bank has formally implemented a new policy, and we will be having an oversight hearing within a couple of months to see how well the Bank has in fact done it.

I will agree with the gentleman—the same kinds of criteria will be applied, I think, by many of us to the IMF. We who are in the American government and are used to openness are puzzled by the resistance we get. I think that is one of the factors that is going to have an influence on whether or not we are going to be able to pass something here, as to whether or not there is some movement in the direction of openness.

Mr. Kennedy. I am glad to hear you say that, Mr. Chairman. And I think that your leadership in regard to changes at the World Bank has been significant, and I look forward to working with you.

Thank you, Mr. Chairman.

Chairman FRANK. Any other statements?

If not, we will proceed to our panel. Our first witness is Jeffrey Shafer, who is Assistant Secretary for International Affairs, U.S. Department of the Treasury. Mr. Shafer has been an extremely cooperative and thoughtful representative of the executive branch, and we appreciate the work that he has done.

STATEMENT OF JEFFREY SHAFER, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF THE TREASURY

Mr. SHAFER. Mr. Chairman, members of the subcommittee, the administration is seeking authorization for a U.S. contribution of $100 million for the interest subsidy account of the enlarged and extended Enhanced Structural Adjustment Facility [ESAF]. This trust provides loans at concessional interest rates to the poorest countries in support of their structural and economic reforms. More than two-thirds of current ESAF programs are in sub-Saharan Africa.

Let me begin with three points. First, ESAF is not an aid program in the conventional sense. It supports the efforts of many of the poorest countries, particularly in Africa, to frame economic and structural reform programs that are essential to sustain growth and development. It has been and continues to be highly effective in this role.

Second, this country's pledge, subject to the approval of Congress, amounts to less than a nickel of every dollar that will be contributed to the interest subsidy account. If we add the $7 billion in bilateral commitments to the loan account, which we are not contributing to, our pledge amounts to little more than one cent on every dollar.

Third, the administration has structured this request to keep the added budgetary cost in our tight 150 Appropriations Account as small as possible while still contributing. It is spread over a 15-year period and will not begin until 1997.

Borrowers from the ESAF have very low per capita incomes; in fact, U.S. support of the program was prompted by criticisms from Members of Congress and others that the IMF was doing too little for its poorest member countries. The ESAF program has established a way to build consensus on adjustment programs within borrowing countries and between borrowers and donor communities. The specific measures that a country agrees to take are outlined in policy framework papers which are prepared by the national authorities with the assistance of both the Fund and the World Bank.

Now, the ESAF programs provide for economic and structural reforms in order to attain sustainable growth and job creation. They are also designed to protect vulnerable groups from potential short-term consequences of adjustment by promoting a shift in budget priorities toward social services and support for social safety nets. The low-income countries can only succeed if they obtain financing on a concessional basis. Adding more hard debts to those they already owe is of no use, and for this reason, the ESAF funds, which enable us to make concessional funds available, are critical.

Let me review how some of the recipients of these funds have fared. Nowhere has the ESAF been more pronounced in its effects than in Africa. This continent has a distressing record of weak growth and increasing poverty. Yet against this background, ESAF support has provided visible benefits to many countries. Take some examples:

Ghana—after a decade of reforms, this country has made major strides toward financial stability and an environment conducive to private enterprise. After several years of negative growth, growth has averaged about 5 percent since 1983.

Uganda is in its 4th year of ESAF reforms. The government has introduced a market-determined exchange rate system and liberalized prices and interest rates. Inflation is down from several hundred percent to single digits. The civil service and military have been reduced in size, and, again, growth last year reached 7 percent and is expected to be 5 percent this year.

Malawi has one of the longer sustained commitments to reform and growth in Africa. There, growth exceeded 11 percent in 1993.

Lesotho achieved a real growth rate of 9 percent in 1993–1994 and has solid budget surpluses.

And Guinea has reduced the size of its civil service by half since 1986 and made progress toward privatization.

Looking to the future, the ESAF is facing a critical challenge to play a role in the context of the January devaluation of the West African convertible franc. The so-called CFA franc zone countries are no longer competitive after 50 years of being tied to the French franc, and their effort to keep their exchange rate fixed was leading to budget deficits, trade deficits, and shrinking national incomes.

The devaluation was an alarming prospect to a generation of West Africans accustomed to low inflation and monetary stability, but it was essential. While the competitiveness of local producers was restored, the prices of imports on which city dwellers had become increasingly reliant were going to increase rather steeply. The Fund responded rapidly by negotiating traditional short-term lending programs and is now negotiating medium-term ESAF loans. These will help in the following ways:

First, they will provide concessional financing. This will allow adjustment to be more gradual and less brutal.

Second, they are promoting policy reforms.

Third, they are providing technical assistance and planning.

Virtually, all the CFA zone countries have begun implementing reforms that will provide them with maximum advantage from the devaluation.

Progress under the ESAF program is not limited to Africa. There are low-income countries with ESAF programs in Latin America and also in Asia. Some of the success stories include Bolivia, which has achieved 4 percent growth in each of the past 3 years; Guyana, which has achieved growth in excess of 5 percent under its ESAF program and reduced inflation to under 10 percent last year; and finally, Bangladesh, which has achieved steady growth since 1990–1991.

Despite the successes that many of the low-income countries have achieved, serious difficulties remain, notably in sub-Saharan Africa.

Now, ESAF programs have not always had as strong, as positive results as they have in the examples I have cited; they have helped prevent further deterioration. ESAF programs are linked with other efforts, including debt relief, and together they help restore hope for a brighter future. I can think of no poor country that has pulled itself out of economic distress without sticking to policy reforms with the support of ESAF and other conditional assistance.

Now let me turn to the structure of the ESAF and how it will work. The interest rates will continue to be 0.5 percent, the loans will be repaid over a 10-year period after a 5½-year grace period. In announcing the new ESAF program earlier this year, the Fund committed itself to be more sensitive to social concerns and working with countries on the design and implementation of economic and structural reforms.

The IMF's public announcement of the new program stated that the programs will pay greater attention to social safety nets; they will include, where feasible, contingency mechanisms to protect programs from unforeseen shocks; they will better integrate technical assistance in program designs and seek to strengthen the quality of public spending.

The U.S. Treasury Department and our Executive Director at the IMF will work hard to hold the Fund to this commitment. But if we are going to be effective, the United States must do its part in financing the facility. Let's take a look at the financing.

As of March 31, more than three-fourths of the original ESAF has been committed and the remaining funds will likely be depleted by year-end. The IMF members agreed to extend and enlarge the facility before the funds were exhausted in order to assure that the poorest countries will continue to receive financial support.

The enlarged ESAF will provide $7 billion in loans with interest subsidies requiring an additional $3 billion. The Fund has contributed $840 million to the interest subsidy account, and the remainder is being met by bilateral contributions.

Now for the U.S. $100 million contribution: Although modest in size, this commitment became a catalyst for commitments from other countries. Had we chosen not to pledge, others would have walked away and funding for the interest subsidy account would have fallen substantially short of the $3 billion required to hold the interest charges to one-half percent. Our contribution was tailored for budgetary purposes to minimize pressure on the 150 Account.

We are asking that the $100 million be spread over a 15-year period beginning in fiscal year 1997. This will average less than $7 million a year. Now, some are asking why we requested this budget authority now, given that we don't need the money until 1997. Why not wait until then? As I noted earlier, our commitment was crucial to get others on board. With the original ESAF due to be depleted by year-end, we had little choice but to come forward when we did. Some IMF members were unwilling to make a commitment while others offered to propose their increase only contingent upon our playing a role.

The U.S. government must now speak with one voice. We need to send a clear message that we are serious about our commitment to this program. Speedy authorization by Congress will complete

the message and provide assurances to other contributors, will enhance our influence in the program, and will provide the Fund with greater flexibility in getting funds where they are needed and greater certainty in planning and formulating programs which stretch into 1997.

Finally, to conclude, our budget realities make it more important than ever to target our limited resources. The international financial institutions provide two clear advantages.

First, their multilateral character and extensive technical resources make them the most effective instrument for encouraging developing countries to undertake economic policy reforms, the reforms that are needed to become self-sustaining economies.

Second, for every dollar that we contribute to the interest subsidy account, $19 are provided by other sources; and including the loan account, the multiplier is even larger.

Perhaps the most important reason to act now is to show that we are not abandoning the poorest countries in the world. Our support for the ESAF program reflects our economic, strategic and humanitarian objectives.

Thank you.

[The prepared statement of Mr. Shafer can be found in the appendix.]

Chairman FRANK. Thank you, Mr. Shafer. Next we will hear from Dr. Joan Nelson, a senior associate at the Overseas Development Council.

STATEMENT OF JOAN NELSON, SENIOR ASSOCIATE, OVERSEAS DEVELOPMENT COUNCIL

Ms. NELSON. Thank you, Mr. Chairman. I would like to discuss three topics: The IMF's changes in approach to poverty and social costs; government ownership of reform programs; and disclosure.

First, I want to focus on how the process of designing and discussing programs, rather than the flow of resources, affects, and can help reduce social costs and improve ownership. Regarding the Fund and poverty impact: As you know, Fund policies have changed dramatically since 1988. Staff have been urged to look for ways to design programs to impact the poor less severely, and to discuss the issue with governments and build safety net arrangements into programs. The real question is, do they do it? My very strong impression is, a lot more than they used to.

I think the change shows very clearly in the French West African countries, which Mr. Shafer mentioned.

The Fund programs that have just recently been arranged with all of those countries in every case include provisions to maintain or to increase spending on health and education. They redesign tariffs or taxes to help offset effects of devaluation on prices of basic goods—grains, kerosene, and medicines.

Some of the programs include temporary subsidies on basic goods. Most include social funds. I don't think that would have happened 4 years ago or 5 years ago. In fact, I know it would not have.

I also believe the specific procedures built into ESAF programs somewhat reinforce the Fund's concern for poverty and social costs. Mr. Shafer explains about policy framework papers. Working out

those policy framework papers has pushed the Bank and the Fund to coordinate with each other a lot more closely. At first, there was a lot of friction. In talking with Fund and Bank people who have been involved in the papers, almost everyone agrees now that each side understands the other's concerns a lot better. What that means is that the Fund is now taking fuller account of growth and poverty reduction considerations that it used to regard as strictly the Bank's business.

The Executive Board of the Fund has been cautious on social costs. It has been very explicit that pro-poor conditions would not be made conditions of Fund assistance, but its new guidelines do emphasize still further attention to composition of social policies, public expenditures, and technical assistance.

In short, I think the Fund is making real progress in paying attention to the social impact of its programs. I don't see a need for specific new programs as distinct from continuing to emphasize the need in general.

Turning to my second point, we all recognize the importance of government ownership. A government owns reforms when it understands them and when it is convinced that they are necessary and appropriate. The PFPs—policy framework papers—are more useful than normal IMF procedures, such as are associated with a stand-by agreement, in helping governments understand the rationale for reforms.

Many of the poorest countries are, of course, particularly short on analytic talent and capacity. These policy framework papers set up a comprehensive framework. They integrate macroeconomic and more institutional reforms. They are updated annually. The discussions with the government include not only the usual contacts with the Minister of Finance and the Central Bank, but also heads of departments like Agriculture or Trade or Education.

What that means is that a wider circle within the government itself is exposed to the broader rationale and has some opportunity to put its own input into the discussion. Incidentally, it also means that Fund staff gets some perspectives they didn't used to get.

The new ESAFs also will have more of something called internal contingency mechanisms. This is, basically, advance permission to take certain actions if projections on international prices turn out to be wrong, as they often are. The added flexibility means fewer requests for formal waivers of provisions in the agreements. It is more realistic. It should help governments believe they can really carry out the agreements.

I believe the PFPs would help ownership more if governments were pushed to take real initiative in writing them. Mostly, they are written now by the Fund in collaboration with the Bank, and then taken to governments and discussed; although increasingly, some governments are beginning to take initiative for drafting. Doing so is easier now that the procedure is well known and the Bank and the Fund have fewer disagreements.

Some governments might need help, but they will learn more if the plans are written in their own capitals rather than in Washington. In short, I believe that the Bank and the Fund should be urged to shift responsibility out of Washington and onto the

governments themselves to draft these papers and their annual updates.

My third point, my message regarding disclosure is brief: Right goal, wrong means. I do think that IMF staff reports and article IV consultations should usefully be made public. I think that release needs to lag 6 months or longer to keep the talks frank. I don't think that disclosure should be made a condition of U.S. funds for ESAF. Much of the opposition to release of these reports comes from executive directors who represent countries entirely different from the ESAF countries. They want consultations to be confidential. It seems to me wrong to try to pressure them by holding back funds for the poorest countries of the world at moments when they most need help.

Thank you.

[The prepared statement of Ms. Nelson can be found in the appendix.]

Chairman FRANK. Next we will hear from Professor Sachs of Harvard, who lives in my district and works in Mr. Kennedy's, so we have him covered.

STATEMENT OF PROFESSOR JEFFREY SACHS, HARVARD UNIVERSITY

Mr. SACHS. Mr. Chairman and members of the subcommittee, I would like to endorse the Administration's proposal for the ESAF, but to stress that it is not quite time to do it because I think that there are very serious problems with the IMF that this subcommittee could be very key in helping to resolve. They do touch mainly on process, but in a way that becomes substance, because the process so much affects the actual content of the Fund programs.

I think it is fair to say that you can't even judge the actual experience of the ESAF since 1987. None of us can for a simple reason: All of the ESAF programs are secret. They have not been released to scholars, to politicians in the member country, to you, to the general public, to other interested parties. That is true not only of ESAF papers, I should stress, but of all IMF documents.

The IMF makes public what it chooses to make public, but the vast majority of all operational documents, loan agreements, terms of policy recommendations, evaluations of programs, results of loans, reasons for suspensions of programs, are all confidential. And not only are they confidential, they have been confidential since 1946.

There is no process of declassifying documents, even for historical purposes, even for scholarly analysis, much less for policy debate; so you can't really know what has happened.

The IMF tells you, we have had great success. Here are six success stories; here are five failures, but those five failures are not our fault. Every one of them is because the government just did not have the will to live up to our commitments.

I have been through this, I would like to stress, having negotiated with the IMF, I think more than any other person in the world—at least for 12 countries and in dozens of cases; and I find the process to be grossly secretive, distorted in terms of the public view, and monopolized by the institution itself. And it has come to the point, I must say, where the IMF even pressures governments

not to have independent advisors in meetings or not to have them, period, because this would be a complicating factor in the negotiations.

And I find this to be also a particularly problematic feature. It is all beneath the surface. You can't find it. You can't find it on a document. But it is the way that the process actually works right now.

Now, I perhaps would be a little bit less exercised about all of this if I felt that things were going along swimmingly, but I don't. I think that there are quite serious problems with many, many IMF programs, including many ESAF programs; but more generally, it is not a problem of the basic direction of IMF advice, I should say, at least not in my opinion.

The basic direction of fiscal stabilization, sensible monetary policy, exchange rate convertibility, open trade, are the right objectives, and I think that they are the right direction for countries to follow. But what I find to be deeply problematic are the tactics in many, many cases. There are very subtle questions of the size of the aid programs that should come, the timing of the package, the sequencing of reforms and, in many cases where I have recently had occasion to cross swords with the IMF staff, on the choice of the exchange rate arrangements and monetary arrangements involving the organization of the central bank.

And I must say that the IMF resisted in a number of countries the very measures which turned out to be enormously successful after the fact; and then the IMF is able to say, after the fact, we supported those policies because there is no documentation to say the contrary.

So if it weren't for this very mixed record which you and I can't evaluate in any serious way, because we lack systematic access to the documents themselves, I would feel somewhat less urgency about this.

I think there are three fundamental reasons for disclosure. In my view, they come to the core beliefs that we, as Americans, hold about workings of governmental institutions; and I think they apply perfectly well to the IMF as well.

First, within the countries that are undertaking these programs, these programs go to the core of social, political, and economic life. And it just doesn't make sense to me that these programs should remain secret from the societies themselves. Nor do I think government should have the option of releasing them. Although I think it is important to stress that time lags on certain things are important, the option of releasing programs doesn't seem to me to be the right answer either, because in order to have the proper accountability even of the borrowing governments, these documents should be released for debate within those countries themselves.

Second, I think it is extremely important for the international policy community, historians, academicians, bankers, participants in financial markets, and the like, that they also have access to these documents for the normal kind of professional scrutiny of this institution.

There is no professional, independent oversight of the IMF at all. Nor, in fact, can there be under these circumstances when one cannot get to the details of what it is that the IMF is actually doing.

Incidentally, many of us have these documents. They either circulate *samizdat*, or you have them when you are an advisor, an independent advisor to a government. But I am going to be presenting a critique of IMF policies at an annual conference of the World Bank next week, and I was forced to expunge from this paper quotations from the IMF documents declaring what their policies are, the very policies that I wanted to discuss, particularly their recommendations on exchange rate arrangements for Russia. They made me take all of this out.

Chairman FRANK. "They" being the World Bank?

Mr. SACHS. "They" being the World Bank.

They said you can't come to our podium and quote from a document that says "Confidential." I said, how can we have a serious discussion? I am hardly talking about movements of troops in the night. All it was was a sentence that said the stabilization fund should come several months after macroeconomic stabilization.

I won't tell you the document. That is only a paraphrase.

Chairman FRANK. You can take a quote from the transcript of this hearing.

Mr. SACHS. Exactly. I have agreed to take it out under the condition that I have an explicative deleted in the paper, saying at this point I would like to quote from an IMF document, but I am being prevented from quoting from it. This is on an issue of fundamental security importance for the world, how Russia is to be stabilized. We can't even have a public debate about this at this moment because all these documents are secret, and even at a conference devoted to this question of what should be done, you have no partner to debate. So that is the second reason, independent scrutiny.

The third reason is the taxpayers. Here is an appropriation; I think taxpayers ought to know that there is accountability for the money in that loan programs are going to be discussed, available to Congress for oversight, but more generally available to the professional community as well.

So I have made several recommendations at the end of my testimony.

First, I again want to stress, I support this appropriation and this authorization for ESAF. I think it is a very good program. I think it is a very good buy for our money, but I don't think that it is time right now. And especially since the money isn't even to come in until fiscal 1997, it seems to me absolutely premature to move right now until you get answers on some of these other questions.

So the recommendations are seven. I will go through them very quickly.

First, I believe the IMF should release all historical documents of 5 years or more. The entire record that has gone to the Executive Board should be available for historians, policy analysts, economists, academics, politicians, and so forth to see what this institution has done. There is absolutely no reason in the world for this stuff to remain secret.

Second, loan documents and all of the accompanying documentation—that is, requests for a standby letter of intent, staff appraisal, and other technical documents that go along with this—should be released 6 months after Board approval of these loans. I think the

delay makes sense to allow for negotiation and because of the sensitivity of advance notice about measures and financial and exchange markets, but after 6 months its seems to me absolutely necessary to have this in full public view and to have all governments required to do this as a condition for receiving these loans.

Third, I would say that other documents—policy framework papers, recent economic developments, Article IV consultations, and other documents that go to the Board—should be also routinely released 6 months after Board review.

Fourth, I would like to see the IMF establish an independent advisory board of distinguished, independent professionals that come from various communities—political scientists, economists, former government officials with the relevant experience—to act as an advisory board and a supervisory board inside the IMF on a rotating basis, but clearly independent of the institution, and to give recommendations to the Board and to be able to review sensitive programs and sensitive issues such as have come up in the highly conflictual area of the former Soviet Union.

Fifth, I would like to see the U.S. government propose other mechanisms to open up this process. Under the current circumstances, governments are actually discouraged from getting independent advice by the IMF in many cases in the field. We should not only stop that discouragement; we should be positively encouraging governments to get independent advice, whether from investment banks or consulting firms of other sorts or the academic community or the broad policy community. And we should have formal mechanisms for those governments to submit independent analyses to the Executive Board of the IMF. The Board should be seeking out this independent advice and to break the monopoly of the staff itself, which right now is the only source for getting information to the Executive Board on program documents.

Finally—it is a longer term and more speculative area—I believe that there are ways to get money to financially distressed countries that don't require taxpayer appropriations, and the analogy that I would use is chapter 11. The bankruptcy court does not have money at its disposal to lend to a financially distressed company. What it does, rather, is to allow that company to borrow under chapter 11 aegis, specifically section 364 of chapter 11, on a priority basis from the capital markets. What it says is, OK, you are bankrupt, you are no longer creditworthy, the next dollars that you borrow will be the first dollars that you repay, the other stuff is going to have to wait.

And the reason that I stress this is that first, it is not necessary for the taxpayers to be the only ones putting capital into these otherwise uncreditworthy countries.

Second, I have had the preposterous experience in two difficult years as Russia's financial advisor to watch the most remarkable spectacle of Russia being unable to get any short-term liquidity support. The interesting historical irony is that both Macy's department store and Russia filed for bankruptcy in January 1992.

Macy's had the good fortune of being protected by chapter 11. On January 27, the date that it filed, all debt service was put at a standstill, and 2 weeks later Macy's got a $600 million loan be-

cause it got the normal debtor-in-possession lending under section 364.

It took Russia 16 months to gets a partial standstill of debt servicing. And it took 18 months to get the same $600 million in the form of the so-called Emergency Import Rehabilitation loan from the World Bank. The difference was, Russia couldn't tap the capital markets on an administrative priority basis as Macy's could. The provisions didn't exist.

This is a long-term issue, but it shows how flawed our institutions are on an institutional level of addressing countries in conditions of financial distress.

Thank you.

[The prepared statement of Mr. Sachs can be found in the appendix.]

Chairman FRANK. Thank you. Finally, Professor Lipumba of the University of Dar es Salaam and Williams College.

STATEMENT OF PROFESSOR NGUYURU LIPUMBA, UNIVERSITY OF DAR ES SALAAM AND WILLIAMS COLLEGE

Mr. LIPUMBA. Thank you, Mr. Chairman. I support the unconditional authorization of the U.S. contribution to the ESAF facility. However, I have five points to make on the IMF policies in developing countries, particularly those of sub-Saharan Africa.

First, on the issue of openness and transparency, to improve the quality of policy design and implementation, adjustment and stabilization policies that the IMF expects African governments to implement as part of the loan agreement should in general be made available to the public, particularly the parliaments of these countries. The IMF and the World Bank do not have a monopoly of wisdom about appropriate stabilization, adjustment, and development policies. Mistakes of wrong design and sequencing of reforms could be avoided by promoting open discussion of adjustment and stabilization policies by analysts outside these institutions. In general, the IMF should adopt an open policy of no objection to the release of policy documents and encourage governments to release these documents to the public.

Effective implementation of policies requires conviction by those who implement policies and public support of the reform strategy. If governments are afraid or unwilling to explain these policies to their own people, how can they build and sustain public support? Transparency and openness is necessary for building political consensus.

Second, IMF stabilization policies have not established the prerequisite for promoting medium- and long-term growth. To promote growth on a sustainable basis requires public expenditures on human resources, particularly education and health, and investment in infrastructure. Stabilization policies have tended to emphasize large expenditure reductions that have fallen on social sectors while tax evasion by the rich has been allowed to continue. Servicing external debt is taking an increasingly large share of government revenue. Large external debt reductions are necessary to reduce budget deficits. Fiscal policies under structural adjustment should prioritize expenditures on primary health care, particularly preventive medicine, education, and the investment in infrastruc-

ture. The IMF, the World Bank, and the recipient country should also utilize the expertise of agencies such as UNICEF that have long experience on appropriate policies for the social sectors.

Third, the World Bank should take the lead in advising countries on adjustment policies.

The IMF does not have a technical comparative advantage in designing medium- and long-term development programs that can establish a sustainable export capacity that will alleviate the balance of payments crisis in the medium term. The World Bank should take the lead in discussing and advising countries that are eligible to use the ESAF resources. Closer cooperation and coordination of the IMF and the World Bank with the recipient country is required beyond the drafting of the policy framework papers to include the setting and reviewing of performance tests. The traditional IMF performance tests of quarterly credit ceilings may appear to be technically objective and relatively easy to monitor, but may not be relevant to the improvement of the balance of payments and restoring growth. Annual review of the overall performance of the economy is a more realistic approach. Improvement of the collection of information on a quarterly basis should continue, which will allow policymakers and other analysts to determine whether their policies are on track and are achieving desired results. However, quarterly and semiannual performance criteria are unrealistic for economies that are dependent on the agricultural sector.

Fourth, more resources should be allocated to sub-Saharan Africa. Since 1984, sub-Saharan Africa, the poorest region in the world, has in each year repaid more money that it has received from the IMF. Many African countries are implementing far-reaching economic reforms. The IMF at least should be required to allocate a larger proportion of the enlarged ESAF to sub-Saharan African countries and attain a significant positive net resource inflow into this region.

Fifth, ownership of the reform process. African governments should play a leading role in designing adjustment programs rather than simply signing a letter of intent to the Managing Director of the IMF, drafted by the IMF staff. Governments should explain their policies rather than react to policies proposed by the IMF staff. The "letter of intent" explaining government policies should be drafted by governments seeking IMF financial assistance. This will encourage governments to employ technically competent people who can effectively negotiate with the Fund and defend the policies to attain consensus within the country. Many stabilization programs have collapsed because they have been imposed by the IMF and lack domestic ownership. The process of designing reforms would be changed and the IMF should be reacting to policy initiatives of African countries rather than the other way around. This process will be promoted by more openness, transparency and discussion of adjustment policies and reforms within African countries.

Thank you.

[The prepared statement of Mr. Lipumba can be found in the appendix.]

Chairman FRANK. I thank all of the panelists for focusing very much on our topic. I am going to begin the questioning with Mr.

LaFalce, but first I want to make one point. When people talk about the need to keep these things secret and the dangers that come from openness, we used to hear, of course, similar things from the Federal Reserve Board. This year the Federal Reserve has simply followed the revolutionary strategy of explaining what they are doing when they do it, and I know of no one who has pointed to any adverse consequences of that or advocates going back to the obscurantism, mysticism, and mumbo jumbo of the past. The arguments for nondisclosure, unless they are very specific where you are going to identify an agent or allow someone to do some insider trading—which is, of course, obviated if everyone gets the information—those arguments I think historically have been proven to be worthless. I am glad to have unanimity that we ought to have more openness, but obviously we are going to have to decide how we do it.

We are not talking about formal conditionality because we can't control what the IMF does. I would note that I don't have a vote on the IMF Board but the IMF doesn't have any votes in the House either. What we are talking about is not so much formal conditionality, but someone recognizing that there should be some simultaneity, because if one thing doesn't happen, neither thing will have the ability to happen.

Mr. LaFalce.

Mr. LAFALCE. Thank you, Mr. Chairman.

Mr. Shafer, you heard the remarks of the other panelists and they are very concerned about a host of issues, but most especially transparency and secrecy. What is the position of the U.S. government, working through its Executive Director, and what are the policies that we are attempting to effectuate with respect to transparency and secrecy?

Mr. SHAFER. We support greater transparency in the IMF as in the other international financial institutions. We put our most intense effort in the multilateral development banks, and I think we have made very large strides in all of them in achieving greater openness; and as the chairman said, we will come back to this Committee to see how much progress we have made in 2 months' time.

We are interested in more transparency in the Fund as well. It is coming along behind—I think the chairman's reference to the Federal Reserve is interesting in this respect. I think the Fed, the central bank, came late and slowly to move toward more openness, but it is doing so. It has not opened all the way, but it has taken further steps; and I think it is reasonable—it is not surprising that, in a sense, the world central bank, the IMF, is coming later and more slowly, but nonetheless is moving in the direction of greater openness with encouragement from us.

Mr. LAFALCE. What does that mean? What encouragement are we giving? What speeches are we making? What deadlines are we setting? Or are we just saying that is general policy, and if they effectuate it 50 years from now that is fine; but what about this week?

Mr. SHAFER. Let me tell about one we lost, but our Executive Director did argue for and vote for the release of IMF Article IVs in

the Executive Board recently. Unfortunately, we lost 22 to 2. So we have a long way to go to build up support in order to do that.

On the other hand, where we made some headway, there has been a major revamping of the public statements that are issued when an ESAF loan is concluded, which provides much more information on the character of the conditions of that loan and the indicators and projections that the Fund is basing that on, and I think that is a very major step. It doesn't do everything we want to do toward more openness, and we intend to continue to press for the release of more information.

I should say, release of the policy framework papers, which are critical to the ESAF process, occurs at the discretion of the government. There is nothing in the IMF rules against releasing a PFP. I have been unable to find out whether any of the countries have released any of them or not.

I think we need to encourage countries as well—it is not always the Fund that is the problem—to be willing to share more information with the people and with the public. And it is something that we are working on and will intend to work on more intensely in the future.

Mr. LAFALCE. I know that the subject of the hearing is ESAF, but since Professor Sachs is here and he has represented a good many countries, but most recently Russia, what is the United States' perspective on the role that the IMF has played in Russia?

In all candor, I am a bit confused. We, certainly, have had a voice and a vote within the IMF, but yet Vice President Gore made certain statements when he was in Russia, Strobe Talbott made certain statements when he was there; and it leaves me a bit confused as to what our policy has been and whether our Executive Director was speaking and voting in accord with that policy.

Can you help enlighten me?

Mr. SHAFER. I don't think I should seek to improvise a resolution of all of the statements that you have referred to.

Mr. LAFALCE. I mean, don't do this for academic reasons. Russia is a real, live problem; and these are all extremely responsible, high-ranking individuals. I am having difficulty making appropriate rhyme and reason out of it. And the consequences are significant.

Mr. SHAFER. The IMF, with very strong encouragement from the United States, did approve the STF loan back in June of last year. It later decided that conditions had deteriorated, and it ought not move ahead with the second tranche; we concurred with that judgment at the time.

We are looking at a situation that changes week to week. We now believe that the second loan should be approved on the basis of a new program that the government has put together, and we hope that it will come to the IMF Board and be approved soon and that the government of Russia will carry through with the commitments that it has made for adjustment there.

It is an extremely important country and an extremely important area for policy, in which one needs to provide support and one needs to maintain the expectations that the Russian government will make the effort that it needs to make to stabilize its economy. And it certainly does mean that with a situation that is changing

rapidly that at one time we are encouraging the Fund to go faster and we may at another stage be encouraging it to slow down, but we think it has been quite responsive to the situation.

The second drawing of the STF for Russia will be considered by the Executive Board tomorrow, and we expect it will be approved then.

Mr. LaFalce. Do you care to comment on the comments of Professor Sachs when he said that it took approximately 18 months for us to go through bankruptcy when it took Macy's 1 day—"us," being Russia—and this brought considerable difficulties?

Mr. Shafer. Jeff Sachs and I are in agreement. I said more than a decade ago that it was part of the problem of the international system, not a positive feature, that there is no bankruptcy proceeding for governments.

The particular delays that took place in deciding how to deal with Russia's official debt are a matter of history now. They took place under the previous administration. And I think—but it was not just the United States. I think many countries at the time were putting too much emphasis on where they were going to get their money from and not enough emphasis on the need to launch a support program in Russia for a critical period of time.

Chairman Frank. I thank the gentleman.

Mr. Bereuter.

Mr. Bereuter. Thank you, Mr. Chairman.

Secretary Shafer, I wanted to ask you two questions that occur because of the comments of other panelists, and then permit them to make supplemental comments if they want. You heard Professor Sachs suggest that the United States wait to authorize and appropriate its contribution to ESAF II until adequate disclosure policies have been agreed to by the IMF board.

In your opinion, what effect would that have on the operations of the ESAF II, and on the countries using ESAF resources?

Second, is the U.S. contribution to ESAF II sufficient leverage to force the board of the IMF to change or would it, as Dr. Nelson suggests, hold the poorest countries hostage to the concurrence of entirely different countries and concerns?

Mr. Shafer. I think there are two risks of failing to appropriate or authorize our participation in ESAF at this time, both of them bad. On the one hand, it could cause an unwinding of the commitments to ESAF II with cost to the countries who expect to benefit from these programs if other countries just decide, "if the United States won't play, we won't play either." And that was a serious risk earlier in the year.

Mr. Bereuter. Do we have any window or length of time that we can make our commitment without having that unravel?

Mr. Shafer. I think the ESAF II needs to be put together this year because that is when the money runs out.

The other risk is that if the world decides our $7 million a year is not critical, they decide that we don't have sufficient leverage, that they do go ahead and provide money, or most of the money that would have been in there otherwise for the benefit of the countries, but we find ourselves having not gained influence in the organization but having lost it as a result.

Mr. BEREUTER. Be explicit. What would that loss of influence result in?

Mr. SHAFER. Basically, we would have less disclosure than I think we can get by pursuing this with a clear signal and the backing of Congress that more disclosure is what we want, but without holding these funds hostage. But we end up with less disclosure and the eroding of our policy influence in the Fund as well.

Mr. BEREUTER. Would any of the other three panelists like to comment on those two points that Secretary Shafer made?

Mr. LIPUMBA. Well, I think I do support the position of the administration that at least the authorization should be made and it should not be made with a lot of conditionalities—and particularly given that it is also a very small contribution, to be quite frank about it.

But also there is an increase of aid fatigue in the parliaments and congresses of many of the industrialized countries. The willingness to assist less developed countries is going down. And I think that you can require the necessary changes or improvement of the disclosure of information by being inside rather than by being outside; and by contributing funds and requiring changes to improve disclosure, you will have a much stronger argument.

As to requesting the IMF to be open, in terms of releasing documents, and to whether developing countries are preventing the release of documents, there is, in many cases, a tendency of both the IMF and the other countries using each other for why documents are not being released. The developing countries would argue that it is our confidential discussions with the IMF, and therefore we are not going to release them; and the IMF will say, these are our confidential documents with the countries that are borrowing funds, and therefore the documents are not going to be released. But if there is a public position that the IMF and World Bank have no objections to releasing these documents and actually promote their release, then you have a better chance of local pressures on local governments leading to release of the documents.

Last, I think there is a problem in terms of having a unilateral decision of the IMF releasing these documents without any general agreement with the less developed countries, because then the debate will be moved away from the issue of transparency to the issue that developed countries or the IMF or the United States imposes whatever it wants on the less developed countries.

So it is important that at least the consensus on the release of information should be together with the governments in less developed countries.

Mr. BEREUTER. Thank you very much.

Mr. SACHS. Congressman, I would be willing to venture or wager that if you just go ahead with this, the chance of getting any real substantive disclosure is exceedingly small. You see, what was just debated was something rather innocuous, Article IV consultations, that is, the general review of the economics. That was rejected by 22 out of 24 Board members. It is an uphill fight. We are not talking about loan agreements, policy advice, conditions attached to loan agreements; that is the heart of it. You are not even going to get close to that unless you put some fire under this; and it seems to me that since the Administration is asking in 1994 for an appro-

priation to start in fiscal year 1997, the idea that this is urgent now is most peculiar.

Now, of course, I start from the proposition that something is rather seriously wrong right now and that you have an extraordinarily powerful institution which really scares the wits out of senior policymakers in these countries. I should tell you, they are scared. They are scared to cross swords with the institution. They are scared, as I say, to hire advisors or even to ask advice.

And I can document that. I would prefer not to, but this is a kind of informal arm-twisting that is most inappropriate. And if we don't have a general policy of open institutions, general disclosure, public debate, and have the idea that somehow, by being on the inside, we are going to get it, I think that is naive.

I should also add, to take another risky step forward, it is not that the Treasury and the finance ministries of the world also want all the disclosure. You have to push a bit for that, because the Treasury and the others—in the case of Russia, for example, you know, I think big mistakes were made. I think the historical record is a mess over the last 2 years. And this loan that is being approved tomorrow, which is a very good thing, it is being approved under conditions markedly worse than when the exact same loan was denied 6 months ago, markedly worse.

And after a disastrous election when the lack of confidence, the sense of confusion was very great because there was no support, among other reasons, well, finally, the IMF decided to come in now and take a fling at it, frankly, because now the amount of tax revenue collections compared to 6 months ago are down probably certainly between 5 and 10 percent of GNP.

It is a much starker situation right now and yet they are lending the money.

Where were we 6 months ago? We should have been lending it in a runup to an election also. These are things that should be discussed and debated openly, and as a matter of routine, not as a concession that this is how such a crucial institution works.

If I could add one historical footnote also. Fifty years ago—and this is the 50th anniversary of the Bretton Woods institutions—there was no capital market to speak of. There was not an international community of expertise on the design of either World Bank-style structural adjustment loans or IMF-style stabilizations. Now there is a vast community inside academia, in consulting firms, accounting firms, investment funds, and so forth, that are all doing the same kind of thing.

The idea that we have to rely right now on this internal, tightly held monopoly makes no sense whatsoever anymore. And any country, in my view, should be able to hire an investment bank that has a track record of assistance and have that advice be the predicate for international official assistance, have their reports go to the Executive Board.

So the whole style, I think, is not right, and it is not going to change without some pressure.

Mr. BEREUTER. Just let me say, Professor Sachs, that I gather from the earlier part of your comments that you don't think it is likely that the world community is going to leave us at the gate and that it is an unlikely situation, in contrast with what the other

professors say. There is no doubt that the IMF is a powerful institution and, for leaders in developing countries, it is a matter of political life or death, not to mention the impact upon the country.

So they are rightly concerned about the power, and they are rightly scared, as you put it, of the results of the way they act with respect to the IMF.

I won't ask another question, but I will see if Dr. Nelson has a response.

Ms. NELSON. It might be useful to try to distinguish two kinds of aims and concerns. One is to facilitate a lot more qualified, external assessment of the Fund's record. That certainly calls for release of the historical documents, and pressing for considerably greater openness on current and recent documents. That is a goal that I, and I suspect everybody here, can heartily endorse.

However, I think there are some delicate issues regarding the release of current or very recent loan documentations at the sole initiative of the IMF. This returns to the point that Professor Lipumba made. Public and academic debate regarding economic policy is vital, and the release of these documents would greatly facilitate that. Indeed, some governments have released them. I don't begin to have full knowledge on this, but I know, for example, that Jamaica on more than one occasion tabled its letters of intent with the Fund in Parliament.

But internal political situations vary greatly. Often economic officials that are trying very hard to do what is really necessary economically against very long internal political odds. That kind of struggle may not die down in the course of 6 months. It may go on for a while. Encouraging the Fund to release documents unilaterally, let's say within 6 months, seems to me to raise some real questions. Instead, one might want to think about encouraging the Fund to encourage governments to release the record of their discussions with the IMF. Taking a very open attitude on the part of the Fund seems to me highly desirable.

Chairman FRANK. Thank you.

Mr. Kennedy.

Mr. KENNEDY. Thank you very much, Mr. Chairman.

I wanted to see if we could get maybe Professor Sachs or one of the other panelists to try to give a little more direct meaning to what actually occurs in some of these countries. I know you did it with Russia, Jeff, but if you could tell me in some of your other experiences, what happens that is positive and what are the downsides of the ESAF program?

When we talk about disclosure, can you just give us a little more human face on the kinds of issues that would come up—let's say, a country in Latin America that has to go through some of these changes, and why it is important to focus on the benefits; but some of the underlying problems and how that could actually help out in a specific case?

Mr. SACHS. Of course, yes. Let me just try to give a brief answer and give an example.

The general direction of these programs is rather similar, country to country. These governments that come to IMF generally come in bankrupt condition; so this is like a chapter 11 workout. And the IMF recommends budget-cutting, it lends some of its own

money, it recommends usually some sort of devaluation or floating of the exchange rate and so on.

Usually, the IMF comes with a draft document, which is the basis of the program and then it negotiates that document, and then the document is sent back to the Fund as a letter from the government so everybody understands this is the general procedure.

This process of negotiating is, in general, quite useful, although I don't think you need to do it with an IMF team, as opposed to any other team that is going to present a document to the official community, but in any event, there are important results that are gained from this.

But there are a lot of key and essential technical aspects of this process once you get past the generalities about open trade and markets and convertibility, once you get back to the specifics. These programs live or die on the specifics. Whether you are pushing a country to have a 60-percent increase in gasoline prices or whether it can be 20 percent because we are going to give another $15 million of aid.

In almost every case that I have lived through, I have fought like the dickens on the side of the government to say to the IMF, you know, you are squeezing so hard, you are going to kill the very people trying to do this. You have to ease up. Now, generally, these governments don't get the kind of input that allows them to do this. And I will give a most remarkable example for Russia or Mongolia or Kyrgyzstan, a number of countries recently.

The IMF often lends its money on the condition that the money not be used. I find this surrealistic in many cases. You have to put the money into the bank as reserves.

The IMF lent Russia $1 billion in 1992 after a great deal of labor, under the condition that Russia not use the money. I could only think—I was in intense pain and suffering, I can tell you, wondering how Boris Yeltsin was sitting there understanding the great Western role, after 6 months of terror of economic reform. So then the Managing Director comes and explains, OK, you get $1 billion—that is $4 a person, incidentally—and you can't use it.

Now, this—I went through the roof publicly, and in the case of Russia, the next year they allowed them to use some of the money. But it is like a fire brigade; in half the other countries, they don't like you to use the money. You have to be there to make the stink.

I cannot tell you right now, and you can't know based on the public record how much of any ESAF loan was actually available to the government for use and how much was bookkeeping as a reserve in the bank. Technically, it is all the governments' money, but if they use any of it that is allowed, you don't qualify for the second drawing, so it is a catch-22. And this you can't know and I can't know, and so when I look at a country failing right now—and they are all failing in the former Soviet Union—it is one big disaster case.

I can't know from the outside whether they are getting adequate assistance, whether the IMF is putting its own money at risk. Whether they are asking the countries to do more than humanly possible. I just know from a dozen other cases that the tendency is to do that.

Mr. KENNEDY. I appreciate your answer.

Mr. Shafer, do you have a response to that?

Mr. SHAFER. Yes, well, there are a number of points being combined here. One is the question of should the IMF be showing more information to the public that would allow a more informed assessment of how well it is doing and——

Mr. KENNEDY. I don't want—Mr. Shafer, could I interrupt you for a quick second?

I would like to ask you to address the response that Mr. Sachs just gave in terms of, you know, the $1 billion that is withheld, the kinds of terms and conditions that you impose and the results of those terms and conditions being kept secret so that these negotiations then, therefore, do not allow for any public debate about the terms and conditions that are being imposed.

Mr. SHAFER. It is a great possibility, and there is an active debate in these countries, to have a debate about what kinds of policies should be followed by these countries. And the fact that one doesn't know all the details of a particular loan agreement—I must say Members of Congress are entitled to look at these documents and to know that for themselves on a confidential basis.

But the fact that Jeff may not in all cases know what was decided does not preclude him, and does not in fact prevent him, from participating in debate on what would be appropriate for this country; and, in fact, informing members of the Executive Board, including our Executive Director, of what one considers appropriate.

So it doesn't completely close the process. One can have a debate about the utility of so-called window-dressing transactions. If it is useful to inspire confidence to appear to give the country more money than in fact you are providing on a useful basis, then, obviously, keeping that secret is essential to being able to pursue that policy.

There may be cases where that is important in reestablishing financial confidence in a country, but I think the Fund probably uses it much too freely, but it is an example if you are going to do it, you have to keep it secret.

Mr. KENNEDY. Barney, I didn't quite understand that, but maybe, Jeff, you could explain what he just said.

Chairman FRANK. I wonder if the gentleman would yield.

Are we talking about lying here? Are we talking about lying, L–Y–I–N–G, pretending that you gave them more money than you gave them, and the reason you can't have openness is that the truth will sneak out? If you tell people that you gave them more than you gave them, you are lying to the world; but you want the world to believe the lying, so they will be nicer to that country, so you cannot tell the truth.

Mr. SACHS. There is even a term of art. Instead of a "bridge loan," it is called a "covered bridge loan."

Chairman FRANK. Do I understand the policy? I am new to this whole area. But you pretend that you gave the country more money than you gave it so that other people will think that it got more money; but you don't really give them the money, and then that is kept secret. Is that right?

Mr. SHAFER. There are occasions in order to provide the reserves where the Fund will attach——

Chairman FRANK. So you make it look like you gave them more money than you gave them, to fake other people into treating them better. Maybe that is a defensible policy. That is new to me, but I am new to this field. Is that what you are saying, that you pretend that you make more money available to them than you have in fact made available? Is that the policy?

Mr. SHAFER. There are occasions when the money is made available, but there are strings attached to its use.

Chairman FRANK. Strings which are in fact intended to make the funds unusable?

Mr. SHAFER. To limit their use. It depends on the particular agreement.

Chairman FRANK. I think you may have said more than you meant to say, and maybe this speaks to policy. But I have to say that you are going to have to persuade me that our being complicit in fooling people, by letting creditors think that the debtor has more money than it has, is a good policy. I am very skeptical.

But it is Mr. Kennedy's time, and I will give it back to him.

Mr. KENNEDY. I appreciate the chairman's clarification.

I would like to turn back to Mr. Sachs for a comment.

Mr. SACHS. I find this policy extremely problematic in all the cases that I know of, actually. And I think it is symptomatic that the IMF, like everyone else, doesn't want to put its money at risk, but we assign them to, in a sense.

And I think that it was very corrosive, in fact; I think it was very corrosive of the relations between the institution and Russia at the time. So the fact of the matter is that there has been almost no money made available. At least when Macy's got its $600 million, they could buy washing machines for the shop floor. Here the money just sat there and the policies were put at extreme risk.

But this happens repeatedly, and you can't know, looking from the outside. And it is not true that you can participate in the debate; it is not true, by the way. The Executive Board doesn't invite testimony.

You know, I had an interchange recently with the Managing Director—several—in public, where he said I had more eloquence than respect for the truth. I can't quote his documents. I know the situation. I have been there. I have seen it. I negotiated.

I know Russia did not get the financing that is waved around, and I know that these documents are not made public. And I think it is very serious indeed that we don't have more openness.

Mr. KENNEDY. Mr. Chairman, I know that my time has probably expired, but I wondered if I could ask another question here.

We have many members that are left in this room that felt very strongly about the policy of supply side economics that Ronald Reagan pursued in the United States and the differences of who would win and who would lose under such a scheme. And I have seen it in Nigeria where I used to work and in Latin American nations where the IMF has come through and imposed a strict regimen on a particular government in terms of spending policies and valuation of its currency; and in many cases, the devastating effect that has on many of the most vulnerable people in those countries.

It sounds as though that debate is almost eliminated from IMF negotiations, and that there is somehow either a wink and a nod

or perhaps at best an agreement by conservative economists as well as liberal economists on the particulars of an IMF imposition of ESAF conditions for a loan, that in large measure eliminate a lot of the—at least I suppose—kind of emotional or belief-based differences that would normally take place on these kinds of issues.

Is that, in fact, the case, that these problems are so glaring in many of these countries that you don't even have to get into the essential mission of what you are trying to accomplish in terms the conservative and liberal aspects that would normally make place on these kinds of conditions?

Mr. Shafer.

Mr. SHAFER. There is a debate, as I said before, and I think we can argue that some more information might improve the debate. There are serious issues about the kinds of adjustment countries follow. I think the Fund has shifted over recent years to more emphasis on protecting the weak members of society. There is more discussion in the Executive Board about can't you do something about military spending, when you have to cut your budget, than there would be some time ago.

But in the end, the countries do have to make their budgetary decisions; and the capacity to ease the terms really depends upon our willingness to provide the resources to tide them over.

Mr. KENNEDY. I understand that you have got the purse strings and so, as I mentioned, I have seen in several countries, the IMF just come in and impose conditions. There isn't a question—I mean, these countries are in such bad shape they have no bargaining chip, so the IMF can impose whatever conditions there are. And so, essentially, what you have is a one-sided debate and, as Jeff says, if you don't even have a free debate on the outside of the process, it seems to me that you can walk in and essentially impose very strict conditions on those countries without any free and open questioning of who wins and who loses. And we have seen in this country conditions under which, when you impose very strict capitalistic formations, what happens is there are a few people that do very, very well and a lot of people end up doing very, very badly. At least that is our experience.

I know my time has expired, Mr. Chairman.

Chairman FRANK. Next is Mr. Sanders.

Mr. SANDERS. Thank you, Mr. Chairman. I don't claim to be an expert in the IMF, but if I understand half of what I have heard today and what I have read, I have some very serious misgivings about a whole lot of policies.

Let me pick up on a point that Dr. Sachs made.

Mr. Chairman, my understanding is that people from HUD—we bring in Henry Cisneros, we want an accountability as to how effectively the very programs that we are funding are doing. And if we find that they are doing badly, we are not going to continue to fund them.

And what I understand from Dr. Sachs is, there has been an enormous amount of secrecy since 1946. I am not sure how we could evaluate whether the money that we have spent has done well or not. Based on that, how any member of the committee could vote for an appropriation in which we have no accountability as to how effectively our money has been spent is beyond my comprehen-

sion. We would not do that for any other agency. I don't know why we would do that for the IMF.

The second point, picking up on a point that Congressman Kennedy was making—I don't claim to be an expert, but my opinion may be a little bit different from my colleagues here—but my understanding, at least—and, Dr. Lipumba, you may want to speak to this—is that in many, many countries around the world after they are finished with the IMF, the poor people are in far worse shape than before the IMF came. And in order to get the loans in countries which are often dominated by the wealthy and the powerful, all kinds of subsidy programs in terms of housing, health care, education, nutrition, and food have got to be cut back in order to live up to the expectations of the IMF for various types of economic stabilization.

I wonder, do we have a track record? How many people have starved to death as a result of IMF policies? In how many countries are the poor and the peasants in worse shape after the IMF? And in how many countries are the rich richer?

We have a great deal of secrecy, so we don't know the answer, but is it possible that our money is subsidizing the rich and causing more misery to the poor?

Mr. LIPUMBA. Well, on the issues of the problems which the less developed countries face and whether we do have some kind of a policy consensus and whether IMF policies necessarily make the poor poorer, in many cases countries go to the IMF when they are already in a very bad situation, with a severe balance of payments crisis and a bankrupt treasury.

There is general consensus that some policies that can restore macroeconomic stability and improve the competitiveness of the country are necessary for any country that wants to implement a reform program.

The differences are that you have to really understand the concrete conditions of a country to see which policies to emphasize, how these policies have to be sequenced, how much adjustment has to be done and how much financial assistance is required in order for these countries to attain sustainable levels of growth that can also improve the conditions of the poor.

So, in the design of the program, understanding the problems a country is facing is quite important. The IMF has technical capacity for designing short-term stabilization policies but does not have the advantage in terms of really understanding what kinds of policies and programs are required to improve productivity for the poor so that you can reduce poverty.

Certainly, the IMF is not accountable here, and it is not accountable in the less developed countries. And it is important for the policies that a country implements to be those policies that can have the support of the poor. And the policies that can have the support of the poor are the policies that increase or improve the productivity of the poor.

And these policies tend to infer a medium- and long-term perspective. However, it will be defeating in a way, because some of the programs which we have in sub-Saharan African countries are the result of having loans at high interest rates from the IMF in the first half of the 1980s, which had to be repaid. And as a result,

African countries are actually not getting new money, new resources from the IMF.

What we do in many cases is to get funds from a third party to repay the IMF in order to have a program for the IMF so that we can negotiate the debt service.

Mr. SANDERS. Let me jump in here because I have a limited amount of time.

Some of us old-fashioned types believe in the quaint item of, quote, democracy. To what degree does democracy exist when the IMF goes into an impoverished country and says, this is what we want; if you need money and you are hurting, this is what you are going to have to do? Doesn't that undermine the ostensible belief of the United States in democracy when you are really holding this money out as a carrot and forcing desperate countries to accept that money on IMF terms?

Mr. Sachs, what is the story on that? You were in Poland for a while.

Mr. SACHS. Well, it is important to keep in mind that these are bankrupt and desperate countries, and the real issue is whether we are doing as good a job as possible in getting them out of the state of bankruptcy. There is going to be a lot of pain in these cases, in general, because nobody goes to the IMF for pleasure, as you can well imagine. So by the time they get there, they are absolutely in desperate shape usually with living standards that are collapsing for all the reasons that eventually bring them to the Fund. And turning that around is typically a long-term, complicated thing that nobody has any magic formula for.

Where we can do best actually is easing the so-called external constraint, how much debt they have to pay back, how much aid they get from other parties, how much money they can use from the IMF itself.

My complaint over a 10-year period of dealing with this is that almost always the IMF fails to give enough help from the outside, either in its own funds or in advocating enough relief on the debt service; and therefore they impose much harder pain on the inside, because in the end you have to live with the resources that you have.

Mr. SANDERS. Let me go back to my question. Try to answer me this one.

Some people might argue that the IMF has enormous power over a significant part of the world, and it doesn't matter—they elect people in this country and that country; it doesn't matter because the IMF holds the strings. Is that a fair statement?

Mr. SACHS. I think that in a crisis, yes, because again governments arrive there in an absolute bankrupt state. They can choose not to use the money, but if they want to use the money, they don't have much choice. Just to be clear, I have watched some success stories and had a little role in some of them, and usually what I have found to be necessary is, kicking and screaming, to say, you can't make this impoverished desperate country pay its debt right now. Or, you have got to give more aid.

And that has been part of my role as an advisor in some of the successful cases, because the IMF didn't think that maybe there is another way to do it, that means mobilizing more outside help. The

only way to make that case is really on the inside or to know exactly what is going on.

I had a huge fight over how much debt relief Poland would get, and I had a huge fight in Bolivia over the IMF in one of the worst human disasters in history, pressing them to continue to make payments on the debts. But by being there on the inside, I was able to make a public fuss.

If this was all public to begin with, we could have a public discussion of this without happenstance. The real way that things work in the world, to put it in a nutshell, is that if you are a country that is important to U.S. foreign policy or important to French foreign policy or British foreign policy or German foreign policy, you have a chance to having some counterweight to the standard bureaucratic procedures. But for an African country that no one particularly cares about, you don't have any counterweight, and therefore it is really just an inside job and no one is standing up for you and saying, you are squeezing us.

And so the irony is that it has been the Latin American countries that have gotten more debt relief in many cases than the African countries, because we cared enough to do something, but in Africa we didn't. And so this is the real problem.

How are we going to put the public scrutiny behind this? One way is to have the someone always there kicking and screaming. But the first thing IMF says is, you don't need any other advisors. We don't think it is a good idea to complicate this argument. If you are not going to do it that way, do it like we always do in America, have public disclosure and an open debate.

Mr. SANDERS. Mr. Chairman, let me give you back the mike and say that I have a real concern about the enormous power that a relatively few people have, who control the IMF, and that power over many countries around the world.

Chairman FRANK. We will be pursuing these issues in this forum.

Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman. I guess I want to follow up with some of the same concerns that my colleague has expressed, and maybe direct a question to Mr. Shafer. And particularly to the part of his paper on page 3 where he seems to be suggesting that the January 12, 1994, devaluation of the CFA franc is a success story.

I am having a little trouble understanding that, and so I wish you would flesh that out for me a little bit, why you think it is a success story and if, in fact, it is a success story, what price some of those CFA franc countries had to pay in the process.

For example, we were in the Ivory Coast and were advised that they had been held up and prohibited from gaining access to funds, even though they had for almost 10 years supported the devaluation. Their funds were being frozen because they had not been able to deliver concurrence on the part of other countries to this devaluation.

So, assuming that—first of all, do you view the devaluation of the CFA franc as a success story? And if you do, why? And if you do, what price did some of the CFA franc countries have to pay for that success story?

And then I would like to get Mr. Sachs' comments on that same issue.

Mr. SHAFER. The devaluation of the CFA franc zone is not a success story yet. With good economic management of the countries, supported by the ESAF and the Bank, they can make it a success story to correct a position that has simply become unsustainable. The currencies in the countries had drifted over the years far out of line with world prices. It meant that the producing people in the countries were getting very little money for what they produced and the nonproducing people were not paying enough for what they consumed.

This has to be corrected in order for these economies to get back on the development track, in order to make the right kinds of adjustments and in order to cushion the shock, because it will be a shock for those people who are going to have to pay more for imports, the provision of funds from the international community through debt adjustments that the United States will participate in—from the Bank, from the Fund, bilateral monies I know that the French will be providing. We hope that we can provide them with the kind of support to get through this period and to quickly get back on the track of growth.

Mr. WATT. The short-term effect of that is that these countries end up paying more money for imports; isn't that——

Mr. SHAFER. They don't pay more money for imports. They pay the same number of dollars. But the purchasing power over imports of the individuals in the cities has gone down; the amount of money that the exporters get has gone up. What you are doing is rebalancing within society—those who produce and give are better off, and those who are taking or consuming are worse off. And so you want to cushion that adjustment.

But what you have to do is improve the lot of the people who are producing in these countries in order to get growth back on track, and that is the objective of this.

Mr. WATT. Well, I am trying to be clear on this. Does that mean the rich get richer in those countries and the poor get poorer?

Mr. SHAFER. Oh, no, often it is the urban middle-class or rich who are the biggest beneficiaries of artificially cheap imports, and it is the poor people in the countryside who are not getting incomes from the crops they produce because of overvalued currency who are the losers, who ought to be made better off. It is not a question of the rich and the poor, but the producers and the consumers.

Mr. WATT. But what conditions did the IMF put on these countries to get them to the point—to get to the point of devaluation? I guess that even if you accept the proposition that devaluation was important, is this one of those situations where on the ground, in the country, basically, the IMF strangled those countries to get them to agree to devalue?

Mr. SHAFER. No, I think more and more, both voices—including, as you said, within these countries—including the French government and the international——

Mr. WATT. The French government is not within these countries, now.

Mr. SHAFER. And the policy of the United States was to encourage these countries to face up to something whose time has come. The IMF didn't dictate the devaluation.

Chairman FRANK. Mr. Shafer, I don't think that you are fairly answering the question. My understanding was that the IMF said you are cut off until there is a devaluation. They didn't say that they would send in the army; they did say that the devaluation was 100 percent conditioned. When Mr. Watt, Ms. Waters, and I were in West Africa last year, we had discussions with the Ivorian government, with the Senegalese government, and they were told flat out, no devaluation, no money from the IMF.

Mr. WATT. And no money from the United States in aid—I mean, it went beyond just IMF monies. It was the implication that the United States was standing behind it and France was standing behind it. You are not getting IMF money, you are not getting USAID money, you are not getting French money. You are going to devalue before you are going to get any assistance here. I mean, is that what happened?

Mr. SHAFER. I don't know the specifics—you obviously have seen more of the correspondence than I did, but certainly all of the institutions were encouraging a devaluation.

Chairman FRANK. Mr. Shafer, I want to interrupt you again. My understanding is that the French were on the other side because to some extent, the problem was that these countries were caught between the French who were reluctant to have them devalue and the others who were pushing them to do so. They didn't simply encourage it; they said, you get nothing. It doesn't do to understate it this way. Don't do that. There was an absolute conditionality there. No devaluation, no money. Why would you understate it that way?

Mr. SHAFER. Because IMF money was not the only source of support that they could have had.

Chairman FRANK. That was not the question. You make me nervous when you tiptoe and dance around. Mr. Watt asked you a direct question. The answer would have been, yes, the IMF said, no money unless you do this. Now, if you want to add other things, OK. But when you understate something like this, where I know the facts, then I have got to worry when that happens when I don't know. That is not a good idea.

Ms. WATERS. Just say you don't know.

Mr. WATT. Professor Lipumba was trying to make a point on this.

Mr. LIPUMBA. The issue of the CFA franc is a difficult one, and certainly the governments there were told that without devaluation there would be no more assistance. And this also emphasizes the importance of having discussions on these issues, because prior to this situation, the IMF did support the CFA franc zone countries with loans and they told them to liberalize their trade regimes. And there were schools of thought that the appropriate kind of exchange-rate system was a fixed exchange rate like the one which was common in that area of East Africa.

So it had loan support in the past. And resources were given, and loans were given, but, of course, as Mr. Shafer has pointed out, the

overvaluation of the currency was there. So, over time, the problems worsened the situation in this particular region.

Mr. WATT. How much of a devaluation was there?

Mr. LIPUMBA. They devalued by 50 percent.

Mr. WATT. So one day if I had—if I was an employee and I was making $100, the next day I was really—I had 50 dollars' worth of buying power? Or 75 dollars' worth of buying power depending on what the 50 percent is off of. If one day to the next I went from having buying power as an employee—as a working person in the country, went to having buying power of 50 percent less?

Mr. LIPUMBA. Purchasing power of imports decreased by 50 percent, effectively.

Mr. WATT. Not only imports, everything; isn't that true?

Mr. SHAFER. No, the devaluation would affect the price of imports, and the part of the support that is provided by institutions and governments is allowing some smoothing through of the increases of those prices. So it didn't hit people all out once.

The total adjustment will be much less than 50 percent. That only applied to imports, and with the support of the international community, that is happening gradually rather than overnight.

Mr. WATT. I had another question, but I am not going to ask it. I want to hear from Mr. Sachs.

Mr. SACHS. To belabor the point, we don't know exactly what happened because, again, the documentation with respect to the IMF is not in the public record.

Chairman FRANK. I know, because I asked them and they told me: No devaluation, no money.

Mr. SACHS. I know informally.

Chairman FRANK. And I suppose I am not supposed to tell people.

Mr. SACHS. This now will have to be stricken from the record.

The second point is, I think, on the economics. It is probably the right policy if you look specifically at the exchange rate, although that would require far fuller analysis. Was it the right amount? Should it have been done earlier and less drastically? What was the nature of the policy change? Did it come at the right time?

And then what I would be very interested in, in all of these cases, is, was there adequate additional support available to help make this thing work from a social and political, as well as economic, point of view? And that, again, requires a full record.

I think it is fair to say that the devaluation was needed at some level because exporters were so squeezed that these countries could not pay their own way in the long run.

And, second, this action by itself does not systematically make the rich richer and the poor poorer; it has the effect of tending to make farmers richer and city people poorer. And as you know, in Africa, there has been a systematic bias because of the political weight of the urban areas as opposed to the rural areas, so that in fact the distribution often goes to those who don't need it. And so it is not the case usually that a distribution toward the farmers and away from the cities works in this harmful way.

But what is also clear, third, is that it is a big change. Now, why is it a big change? Because like many things, it was an adjustment very long delayed. And so by the time you get there, things have

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really been held tight so long that, boom, they just can't be held longer; and second, because we don't cushion such changes even with modest amounts of money that could make a huge, huge difference.

I know, not in these cases, but in areas where I am working in Central Asia—for instance, in Kyrgyzstan—that the provision of $20 or $30 or $40 million can make a profound difference to the success or failure of a government when it is asked to carry out these other policies; but that is usually not seriously factored in and certainly not subject to public scrutiny.

And so this is exactly the kind of thing that should be—where even if, beforehand, you can't have the agreement on exchange rate—that is a particular case, where you can't have that announced 2 weeks beforehand—certainly, we want to know after the fact, at a minimum, what has happened for the last 15 years in the CFA relations with the IMF so that it came to this, and what were the conditions put on so that we can analyze this case.

And I would love to show you the documents from many other countries as well where there are clear problems, where small amounts of aid could have made a very big difference to the success of a policy that is correct but highly problematic socially.

Mr. WATT. Mr. Chairman, I appreciate it. I guess I would be less than candid if I didn't express some discomfort at some of the things that I have heard this morning. It sounds to me—I was just making some notes here; the IMF, in a lot of these cases, is running these countries basically as a bankruptcy court administrator.

We don't know how the money is being spent. The leadership of the country doesn't even tell its people it is getting debt when these countries, the leadership, may in fact be mortgaging the future of the country. The lender is packaging the loans and discouraging countries from getting independent advice, which strikes me as kind of being like a bank telling the small businesses in this country what loans they will have and how they should mortgage their natural resources or good assets to pay for it.

And I guess it just troubles me that this entire process—and maybe it is necessary, by the point at which these countries are—but the whole process strikes me as being very paternalistic, and that is always troubling to me.

Thank you.

Chairman FRANK. I thank the gentleman.

Let me say, I am going to send this transcript over to the IMF. I know they monitor things. I think while we have no legislative control over them, obviously, I think it would be useful for them to see the extent to which some of the Members of this body, the House of Representatives, who are the most interested and the most supportive of trying to help poor people, people who are generally very, very much in the forefront of willingness to commit American resources to help alleviate poverty throughout the world, have this degree of unhappiness. And I think that is very important.

When the people who ought to be your best allies in efforts to alleviate poverty internationally and ought to be your allies on this subcommittee have this view and when there is some degree of un-

happiness on the part of the public, I think it is very important for the IMF to know about that.

Ms. Waters.

Ms. WATERS. Thank you very much, Mr. Chairman. Let me just say as I start my comments and my questions that I share the frustrations of my other colleagues who have spoken about the IMF and our ability to do something about the problems that we see. I also share frustration with our ability to ask—or inability to ask questions and get answers.

And I am also a little bit ashamed. We went on a trip to Senegal, Cote d'Ivoire, and Ghana, and we were buttonholed everywhere we went saying please, please, please, please help. And we said that we would do everything we could do to have the pleas of those nations heard when we got back here.

And I guess I am ashamed to go back, because if we go back, we are going to hear the same thing; and I don't know that we can tell them that we were able to get anybody to listen to us.

As I understand it, between 1988 and 1992, there was a net transfer of over $2 billion from sub-Saharan Africa to the IMF. For example, in that time period, Ghana's net transfer to the IMF was $276 million, Zambia's was $252 million, Kenya's was $111 million, and Cote d'Ivoire exceeded $480 million.

Now, as I understand it, the purpose of ESAF is to provide concessional financing to countries that need such resources while undertaking economic reform programs. Yet, it appears the IMF has consistently been drawing more money out of poor countries than it has been providing them in loans.

In the 5-year period between 1988 and 1992, the net transfer of over $2 billion from sub-Saharan Africa to the IMF—we understand that is how much it is. I want to know from Mr. Shafer whether or not you consider this a problem, and if so, since these countries make huge repayments to the IMF, they are mostly on market rate loans they received before ESAF ever existed, shouldn't we consider rescheduling their old debt similar to the World Bank's program that cut interest payments for international government agencies?

And somebody tell me, what happened in Ghana, which is supposed to be the shining example of restructuring and folks who worked very, very hard to do everything they were told to do. They paid their debt, and they are no better off. Please explain that to me.

Mr. SHAFER. First of all, the numbers I have here show that in 1988 to 1990, there were net repayments to the Fund from sub-Saharan Africa. The numbers I have don't sound as though they are as large as the ones you use. But I think the important thing is that after 1990, it turned into a net flow of resources from the IMF to these countries. And that was made possible by the ESAF, and we will be able to continue it if we, in fact, continue and extend the ESAF program.

The Fund is not an aid institution. It is a monetary institution that, by and large, lends money—short-term money; and the problem is, if they don't turn around, they wind up having to repay that before they are out of trouble.

ESAF is a mechanism of stretching that out to 10 years and having more time for them to get on their feet. But in the end, we need to look at the broader support system that we have for these countries. Our bilateral support unfortunately is getting very, very small, but we do have the money in the IDA facility, the soft loan facility of the World Bank, which is a critical resource in order to keep money flowing to these countries.

In the end, we are going to have to find more conditional money, not the hard money that they have to repay in a few years, if we are going to give these countries the support that they need. That includes the support for debt forgiveness that I think is going to be crucially important to find money.

Ms. WATERS. What happened to Ghana?

Mr. SHAFER. Ghana got down. They were just about at zero last year. But it does have the benefit of having followed policies.

Ms. WATERS. What policies?

Mr. SHAFER. That partly means it doesn't need the IMF's kind of emergency support——

Ms. WATERS. What benefits? What benefit did it reap from having paid off its debt?

Mr. SHAFER. It is no longer—it has paid off some of its debt. It is no longer borrowing from the IMF. It is getting resources from the other international financial institutions in support of its policies, and it is growing. That is the most important benefit of all, it is growing.

Ms. WATERS. What rate of growth? I mean, how is this growth—describe this growth. Why did they put us in a airplane and take us up to the dam in order to get us to really listen to the problems that they are having wanting to grow?

Chairman FRANK. And not being able to afford a copilot.

Ms. WATERS. Yes. Barney was the copilot.

Mr. WATT. Would the gentlewoman yield?

Ms. WATERS. Yes.

Mr. WATT. I wanted to, interestingly, make a parallel between this and welfare reform. It is kind of like as soon as you start making any money, then they cut you off and put you back in the situation where you go back on welfare.

Ms. WATERS. Can they borrow money from the IMF now? Can they?

Mr. SHAFER. I believe—I believe they can. I am not sure it would be the right thing for them to borrow hard money that they would have to repay soon. I think we really need——

Ms. WATERS. Where can they get some money? Their professors are going to leave the country. They make $200 a year or something so ridiculous that I can't remember what it is, and they cannot develop a professional middle-class in order to develop their country because they have no money.

Somebody tell me what I could say to President Rollins when he describes this to me. Anybody. Just tell me. Please.

Mr. SHAFER. I think you have put your finger on the need, I think——

Ms. WATERS. No, no, no, I know the need. I want some answers. Help me. Please.

Mr. SHAFER. We have got to find the capacity to commit more money to concessional assistance—that is, not on hard terms—in order to support this.

Ms. WATERS. Where we are going to look? I will look. We have to—what do we do? Where?

Mr. SHAFER. We are appropriating the funds that we require for IDA. That is one of the most important things, keeping intact the appropriations both for multilateral and bilateral assistance. I think it is not enough, but it is what the President was able to put on the table; it is an increase over last year.

Ms. WATERS. Let me interrupt to say this. If I had a little wish, a teeny one, I would say to everybody, let's take one country who has done everything we said it should do, and let's make an example out of them and say to the other countries, we were right, see. See what they have done? They have done so well and now watch all of this flow of resources, watch all of this support that we are going to give them because we are going to reward them.

Now let's just stop and concentrate on one country. Let's take Ghana, and can't we collectively put together a package. I don't care where we get it from, here, there, everywhere, underneath, above, beyond. And let's put it together and deliver it and say that our word means something, that our policies mean something and that we don't lie. We make good sense.

Can we do that? Can somebody help me to do that?

Mr. SHAFER. I would be glad to work with you to see what it is possible to put together—we have got to reward success.

Ms. WATERS. Mr. Chairman. Mr. Chairman. Can we—those of us, all of us who want to make sense out of this, can we pull in whomever—Mr. Shafer and whomever he tells you to a meeting in your office? Can we sit down with all the potential resources and come up with a figure that we are going to work to deliver to Ghana because they complied?

They did it. And they are begging.

They want the growth. They have done everything.

Can we put together a package that everybody can start to work on so that when we go back, instead of saying, they lied to you, we don't have any answers; we can say, let me tell you what we have done since we discovered what the problem is, and this is what we have been able to put together.

Can we do that and can we start with that tomorrow? Can we draw in a meeting tomorrow of relevant persons who have gotten their finger on some money somewhere and do it? And can you give us some leadership in that?

Mr. SHAFER. I am glad to work with you on it. I don't have my finger on the money, but I am certainly glad to work with you.

Ms. WATERS. No. You tell us who has got their finger on the money. I want you to tell me every pot of money that we can break down, and then we are going to summon them over to meet, if my chairman agrees.

I am sick and tired of this. I don't know how to solve problems except to solve them.

Chairman FRANK. One of the things I have become increasingly distressed by is the split jurisdiction, both within the executive branch and here, between the foreign affairs-State Department-

AID complex for bilateral giving and the Treasury-Banking Committee for multilateral giving.

That is unified in the Appropriations Committee, but one of the problems, I believe, is that we—both branches—have not done enough. And I am going to take the gentlewoman up on that, not tomorrow but sometime next week. And I will consult with Mr. Gejdenson and Mr. Johnston—Harry Johnston, chairman of the Africa Subcommittee, and Sam Gejdenson who chairs the bilateral foreign aid one—and we will try to move that together.

Because I will say that one of the problems that bothered me is that I understand that our Treasury Department has tried on a number of occasions to promote reforms—we saw this with the World Bank and the IMF and the effort to open up—and we get outvoted. But part of the problem is that we have not brought the State Department into this. There has been so much turf consciousness on the part of our own departments. It is done Treasury-to-Finance Ministry, and we have not made a coordinated enough effort to get all the resources of the government.

I don't want to be told that we don't have enough votes until I have seen the efforts that the State Department and other agencies involved in international issues have made to do it. Because when you go to the finance ministries to set the standard of openness in government, I think I would sell all my newspaper stock.

One thing that we could do to increase aid to those countries, which won't cost us anything unless we pretend that it does, is to value more realistically the debt that we write off. I am convinced, and Dr. Key, the staff director, has looked into this, that we have an artificially high value that we have placed on uncollectable debt; and therefore, when we do debt relief—and we increased the authorization for debt relief on the motion of the gentlewoman from California—we charge ourselves an unduly high figure. If we more realistically valued the debt, we could in fact increase aid to these countries at no cost to ourselves.

That is one of the things that we are going to press more.

Mr. WATT. Did we devalue our debt when we forced devaluation of the CFA franc?

Chairman FRANK. No, because that was in hard currency. They owed us hard currency.

We have looked at it—Dr. Key and others have looked at it—and let me put it this way: If anybody held that debt and somebody offered to pay them what the U.S. government values it at, I think they would take it very quickly. I cannot believe that anybody would believe that valuation is realistic. OMB and CBO put too high a valuation on the debt—a more realistic valuation is one way in which we could get some relief without it costing us any additional money.

But I will take the gentlewoman's suggestion, and we will speak to Treasury and to State, and with the approval of our colleagues on Foreign Affairs, have such a meeting.

Ms. WATERS. Thank you very much.

Chairman FRANK. I have just a couple of other questions, because we have to get moving.

The one thing that I did want to talk about was involving State. As far as conditionality is concerned, we are not here talking about

explicit conditionality, but I hope the IMF is taking full notice of this.

Some of the Members of this body who are the strongest supporters of using American dollars to try to alleviate poverty are ambivalent, at best; and nobody is going to get a bill through authorizing this money unless some of these concerns are met. That is not a condition, it is something more imposing than a condition. It is a fact. It is a political fact that people had better take into account, and if there are no changes, I wouldn't bet highly on the authorization. I think that is an important issue for people to understand.

One other point that I did want to stress, Professor Lipumba brought up something that was of concern to me, and this will be the last question. But that is the question of IMF–World Bank cooperation as there has been a convergence of their roles to some extent. You touched on that, Professor Lipumba.

What is the current state of that? Is that something we should be looking into to encourage the institutions to do a better job? From the standpoint of a potential recipient, what is the state of IMF–World Bank coordination of their policies these days?

Mr. LIPUMBA. It is improving, but it requires much more improvement, in particular when you have the evaluation of the specific stabilization programs or ESAF programs. Usually, the Fund goes alone and you don't have the World Bank people; and the World Bank people go alone and you don't have the IMF staff, so that it is still inadequate.

Chairman FRANK. Mr. Shafer, we may want to look at this further along. I will ask Treasury to pull together your sense of this later this summer or early this fall. That is something that we are going to return to, the coordination of the roles of the IMF and the Bank. This has come up before, and I was glad Professor Lipumba mentioned it.

I want to thank the panel. This has been very useful for us. I think you see Members genuinely grappling with intellectual, political, and economic problems. There is a genuine predisposition here to help, but there is going to have to be a lot of work before that can become a reality.

The hearing is adjourned.

[Whereupon, at 12:14 p.m., the hearing was adjourned.]

APPENDIX

For Committee Use Only
Embargoed Until Delivery
Expected at 10:00 a.m. on April 19

STATEMENT BY THE HONORABLE JEFFREY R. SHAFER
ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS
BEFORE THE SUBCOMMITTEE ON
INTERNATIONAL DEVELOPMENT, TRADE, AND MONETARY POLICY
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES
APRIL 19, 1994

Mr. Chairman. I welcome the opportunity to testify before this Subcommittee about the extension and enlargement of the Enhanced Structural Adjustment Facility (ESAF). The ESAF provides an important example of the critical and effective role played by the International Financial Institutions (IFIs) in advancing U.S. economic, strategic and humanitarian goals.

Introduction

The Administration is seeking authorization for a U.S. contribution of $100 million to the interest subsidy account of an enlarged and extended Enhanced Structural Adjustment Facility (or ESAF). This trust is operated by the International Monetary Fund. It provides loans at concessional interest rates to the poorest countries in support of structural and economic reforms. More than two-thirds of current ESAF programs are in Sub-Saharan Africa. The funds and the policy reforms they encourage improve prospects for growth and development in these countries. Economic development is the only way to reduce the widespread poverty in them.

Let me begin by making three points about the extension of the ESAF:

o First, ESAF is not an aid program in the conventional sense. It supports the efforts of many of the poorest countries, particularly in Africa, to frame economic and structural reform programs that are essential to their sustained growth and development. It has been and continues to be highly effective in this role. Ghana, Uganda, Malawi, Lesotho and Bolivia are among the countries that have shown significant improvements in growth, lower inflation and expanded exports under ESAF programs.

o Second, the United States' pledge, subject to the approval of Congress, amounts to less than a nickel of every dollar contributed to the interest subsidy account. If we add the $7 billion in bilateral commitments to the loan account, our pledge amounts to little more than a penny of every dollar. It is a meager share for the largest economy in the world -- much less than our 18 percent share of the IMF quota.

- Third, the Administration has structured this request to keep the added budgetary cost in our 150 Account as small as possible while still contributing. Our request would be spread over a fifteen year period that would not begin until FY-97.

Background

The international community responded in the mid-1980s to the growing crisis in the low income developing countries by providing the IMF with the Structural Adjustment Facility (SAF) and the ESAF. These facilities have provided nearly $12 billion in concessional resources to help low-income countries initiate measures to improve their balance of payments and foster growth over the medium-term.

Borrowers from the SAF/ESAF programs have very low per-capita incomes. Many face high rates of inflation, declining export prices and deteriorating balance of payments positions. In many of these countries, external sources of finance vanished as their need increased, making it clear to the international community that something needed to be done. In fact, U.S. support of the SAF/ESAF programs was prompted by criticisms from Members of Congress and others that the IMF did too little for the poorest member countries.

The SAF/ESAF programs have established a way to build consensus on an adjustment program within the borrowing country and between the borrower and donor communities. The specific measures that a country agrees to take are outlined in Policy Framework Papers (or PFPs), which are prepared by the national authorities with the assistance of the Fund and World Bank. These papers provide an outline for the country's macroeconomic and structural policy objectives for the coming three years, identify the strategy that will be followed, and estimate the financing that will be required. The participation of the Bank and Fund provides a catalyst for additional financial support from bilateral aid donors.

ESAF programs provide for comprehensive economic and structural reforms that seek to foster sustainable growth and job creation. They also seek to protect vulnerable groups from potential short-term consequences of adjustment by promoting a shift in budget priorities toward social services and support for social safety nets. It is important to recognize that low income countries can succeed only if they can obtain financing on a concessional basis. Adding more debts to those that they already owe is of no use. A lasting poverty alleviation program also requires increased economic opportunities and implementation of sound macroeconomic policies. Let me review how recipients of these programs have fared.

Experience under the ESAF

In the mid-1980s, when the SAF/ESAF programs were introduced, weak economic conditions, sharp declines in the terms of trade and inadequate policy responses to emerging problems had left most low income countries with minimal growth and rising external

imbalances. In fact, real GDP declined in two-thirds of the countries in the three-year period preceding implementation of ESAF programs.

Nowhere has the ESAF had a more pronounced effect on growth and development than in Africa. The continent had a distressing record of conflict, weak growth and increasing poverty. Yet against this backdrop, ESAF support has provided benefits to many countries. For example:

- **Ghana**, after a decade of reforms, has made major strides toward financial stability and an environment conducive to private enterprise. After experiencing several years of negative growth, GDP growth has averaged about 5 percent since 1983. The exchange and trade regimes have been liberalized. There also have been substantial improvements in social indicators. Ghana, in fact, graduated from the ESAF program in 1991. While the 1992 elections caused fiscal and current account deficits to increase, the government took corrective actions in 1993 and remains committed to economic reform.

- **Uganda** is in its fourth year of ESAF reforms. The government has introduced a market-determined exchange system and has liberalized prices and interest rates. Inflation has declined from 240% in the late 1980s to single digits today. The civil service and military have been reduced in size. Real GDP growth last year was 7% and is expected to be 5% this year.

- **Malawi** has one of the longest sustained commitments to economic reform in Africa. Economic growth exceeded 11% in 1993, and the exchange rate is fully market-determined.

- **Lesotho** achieved real GDP growth of 8.7 percent in 1993/4, and has a solid budget surplus, falling inflation, and a comfortable level of reserves.

- **Guinea** has reduced the size of its civil service by nearly half since 1986, liberalized its trade regime, and made substantial progress in privatization.

Looking to the future, the ESAF is proving its value in the context of a truly historic event: the January 12, 1994 **devaluation of the CFA Franc.** This currency, used by 14 African countries, had been linked to the French Franc at a rate of 50 to 1 since 1948. After half a century, this rate had come to be far out of line with economic reality. The CFA Franc Zone countries were no longer competitive, and trying to stay afloat was leading to budget and trade deficits.

Devaluation was an alarming prospect to a generation of West Africans accustomed to low inflation and monetary stability. While restoring the competitiveness of local producers, the prices of the imports on which city dwellers had become increasingly reliant were going

to increase rather steeply. The Fund has responded rapidly by negotiating traditional short-term lending programs, and by moving to negotiate medium-term ESAF loans. ESAF programs can help in the following ways:

- Concessional Financing to Allow More Gradual Adjustment: ESAF terms are highly concessional, providing a strong incentive for policy reform. The concessional terms ensure that Fund support does not compound already heavy debt burdens.

- Policy Reforms: The Fund and World Bank have worked together with countries in difficult circumstances to agree to policy reforms required to support growth and jobs. For example, in the CFA countries, these programs support far-reaching adjustment policies that should help ensure that the benefits of the currency realignment are preserved and the short-term social costs are alleviated as much as possible.

- Technical Assistance and Planning: An essential part of any ESAF program is an integrated package of medium-term policy plans and performance targets designed to help ensure the success of the reforms.

Virtually all CFA countries have begun implementing reforms designed to gain maximum advantage from the devaluation. **Benin, Burkina Faso, and Mali** already had ESAF agreements in place and are strengthening their reforms. **Cote d'Ivoire's** program was approved last month. **Cameroon, Niger, Senegal, Chad, CAR and Comoros** have received interim programs and should reach agreement on new ESAF programs soon. **Congo** and **Gabon** are not eligible for ESAF, because their incomes exceed the maximums permitted under the program.

The availability of ESAF was critical in helping countries through the devaluation. In the future, the United States and other donors will rely on the IMF and the World Bank to provide quick cash infusions and to be the major sources of new funding for these and other African countries in the years ahead. Without ESAF, we would be hard-pressed to find the more than $1.5 billion this program already has made available to Africa.

Progress under ESAF programs is not limited to Africa. Several low-income countries with ESAF programs in Latin America and Asia have made remarkable achievements.

- **Bolivia** has achieved 4 percent growth in each of the past three years, following nearly a decade of severe balance of payments imbalances and negative growth.

- **Guyana**, with foreign debt amounting to more than six times its GDP, has achieved growth in excess of 5 percent under its ESAF program, and inflation has declined from more than 75 percent to slightly less than 10 percent last year.

o **Bangladesh** has reduced its budget deficit, inflation rate and current account deficit while increasing domestic savings. It has achieved steady GDP growth since 1990/91. The country successfully completed its ESAF program in September 1993.

Despite the successes that many of the low income countries with ESAF programs have achieved, serious difficulties remain, notably still in Sub-Saharan Africa. Where ESAF programs have not had significantly positive results, they have in many instances helped to prevent further deterioration. ESAF programs are linked with other efforts, including debt relief, that will help to restore hope for a brighter future in many of the most impoverished nations of the world.

Structure of the ESAF

Let me turn now to the structure of the extended and enlarged ESAF, which I know is of particular interest to this Subcommittee.

The terms and conditions of programs under the enlarged facility are identical to the original ESAF. Loans will be provided to low-income IMF members that are undertaking three-year economic reform programs to strengthen their balance of payments and improve their growth prospects. The interest rate on ESAF loans will continue to be 0.5 percent, with the loans being repaid over a ten year period with 5-1/2 years grace.

In announcing the ESAF program earlier this year, the Fund committed itself to be more sensitive to social concerns in working with countries on the design and implementation of economic and structural reforms. The IMF's public announcement of the new program stated that ESAF programs will: pay greater attention to social safety nets; include where feasible contingency mechanisms to protect programs from unforeseen shocks; better integrate technical assistance into program design; and seek to strengthen the quality of public spending.

The United States Treasury Department and our Executive Director at the Fund will work closely with our counterparts to carry through on this commitment. But if we are going to be effective, the United States must do its part in financing the facility. Let us take a look at how it is to be financed.

Financing the Extended ESAF

As of March 31, more than three-fourths ($5.4 billion) of the original ESAF ($7.1 billion in loan capital) has been committed, and the remaining funds will likely be depleted by year-end. IMF members agreed to extend and enlarge the facility before this happened to assure that the poorest countries continue to receive financial support for their efforts to promote reforms and achieve self-sustaining growth.

The majority of the financing for the enlarged facility is comprised of bilateral contributions. The enlarged ESAF will provide $7 billion in loans with interest subsidies that will require an additional $3 billion. The Fund has contributed $840 million to the interest subsidy account, and the remainder has been met through bilateral contributions.

As of end-February 1994, commitments had been received from 43 countries. In addition to commitments from industrial countries, 24 developing countries have put in 20 percent of the contributions to the interest subsidy account. The broad base of financial support affirms both the need for and the effectiveness of the facility.

U.S. Contribution

Although modest in size, the U.S. commitment to contribute $100 million became a catalyst for commitments from other countries. Had we chosen not to pledge, others would have walked away and funding for the interest subsidy account would have fallen substantially short of the required level of $3 billion.

Our contribution was tailored for budgetary purposes to minimize pressures on the already overburdened 150 account. We are requesting that the $100 million be spent over a 15-year period with outlays to begin in FY-97. The annual outlay for this program over the fifteen year period will average less than $7 million.

Some ask why we are requesting budget authority now, given that the money will not be needed until FY-97. Why not wait until FY-97 to request authorization and appropriation? As I noted earlier, our commitment was crucial to get others on board. With the original ESAF due to be depleted by year-end, we had little choice but to come forward when we did. Some IMF members were unwilling to make a commitment while others offered to increase their proposed commitments contingent upon a contribution from the United States.

The United States Government must now speak with one voice and send a clear message that we are serious about our commitment to this program. Speedy authorization by Congress will complete the message. It will provide comfort to other contributors, and will enhance our influence in the program. It will also provide the Fund with greater flexibility in getting funds where they are needed and greater certainty in planning and formulating programs that stretch into 1997.

Conclusion

Our budget realities make it more important than ever to target our limited resources. The International Financial Institutions provide two clear advantages.

- First, their multilateral character and extensive technical resources make them the most effective instrument for encouraging developing countries to undertake the economic policy reforms needed to become self-sustaining economies.

- Second, for every dollar we contribute to the interest subsidy account, nineteen dollars are provided by other sources. And including the loan account, to which we are not contributing, the multiplier is even larger.

Perhaps the most important reason to act now is to show that we are not abandoning the poorest countries of the world. Our support for the ESAF program reflects our economic, strategic and humanitarian objectives.

Thank you, Mr. Chairman and Members of the Committee. I would be pleased to answer any questions you may have.

Statement of Joan M. Nelson

Senior Associate, Overseas Development Council

before the

Subcommittee on International Development, Finance, Trade and Monetary Policy

of the

U.S. House of Representatives Committee on Banking, Finance and Urban Affairs

regarding

"The International Monetary Fund and the Administration's request for authorization of the U.S. contribution to the Enhanced Structural Adjustment Facility."

Tuesday, April 19, 1994

Washington, D.C.

The views expressed are my own, and do not necessarily reflect those of the Board or Staff of the Overseas Development Council.

I appreciate the opportunity to testify before this committee. I would like to address three topics:

1. Changes in the International Monetary Fund's approach to poverty and social costs issues, in general and with specific reference to the Expended Structural Adjustment Facility (ESAF).

2. The impact on borrowers' commitment ("ownership") of the way in which ESAF programs are planned and implemented.

3. Increased disclosure of IMF staff reports on Article IV consultations.

Before addressing these themes, it may be useful to briefly state my basic assumptions regarding the role of ESAF.

The countries eligible for ESAF are the world's poorest. They need a wide range of assistance to rekindle growth, overcome structural weaknesses, and address poverty. The IMF is part of a larger team: it focusses on basic macro-economic management and balance of payments issues, while the World Bank, the regional banks, and bilateral donors address longer-term development and poverty reduction. Sustainable macro-policies are absolutely essential, although far from sufficient, for growth; growth, in turn, is essential for reducing poverty. Most poor countries badly need advice and support with macro-economic management. If the IMF does not do the job, someone else must. The World Bank is less qualified to deal with these issues than the Fund. It is also over-extended already. The Fund, then, has a crucial if limited role.

The Committee will probably want to consider whether the ESAF timeframe is appropriately long-term. I'm sure you will be hearing from many who are better qualified than I to comment on that question. I do note, however, that especially in the context of the poorest countries, many institutional and structural changes may take several years to begin to produce significant economic gains -- quite possibly longer than the five and a half year ESAF grace period.

A second, still more important question relates to the adequacy of financial support for the reforms being encouraged -- not only from the Fund, but from all sources (including debt relief). Many informed observers think that support has been inadequate in a number of cases, and that this may be one reason why a high proportion of Fund programs fail.

Turning to my three more specific topics:

1. <u>The IMF is increasingly concerned with social costs and the impact of its programs on the poor, although its progress is slower than many of us might like. ESAF is an important instrument encouraging this trend.</u>

IMF views on its role with respect to the social costs of stabilization have changed dramatically over the past decade. Changes in advice to governments and design of programs have been more limited, but have become clear in the last few years.

The Fund traditionally argued that its responsibilities did not include attention to the effects on different groups of the broad policies it recommended. As late as the mid 1980s, it would go no further than to state its willingness to discuss social costs and ways to reduce them if the government raised such issues. Since 1989 there has been a decisive shift in policy. Managing Director Michel Camdessus has strongly urged staff to consider poverty questions, especially in low-income countries, and to take initiative in discussing with governments the social impact of macro-economic policies. The guidelines call on staff to consider, for example, how to improve the quality and not only the quantity of fiscal adjustment, by focussing budget cuts on programs less important to the poor. Where budget and balance of payments constraints leave too little room for maneuver, staff are urged to identify specific measures to help buffer social costs, such as targetted subsidies, public works programs, or re-oriented pension and other social transfers (these last mainly in ex-Communist countries which have extensive social security systems). Missions are instructed to assess the costs of safety net provisions and to make sure they are consistent with the macro-economic frame of the program. And they must report to management on their analysis, dialogue, and advice regarding social impact.

Predictably, actual practice has accomodated only gradually to management directives. At the outset some staff were enthusiastic but many were skeptical. Seminars, orientation for new staff, and gradually accumulating experience have helped to change attitudes and improve capacity. Discussions of fiscal measures now routinely consider the pattern of expenditures. There is increased discussion within the Fund itself and between it and governments regarding "productive" versus "unproductive" outlays, including military spending.

For varied reasons, much of the Executive Board has not wanted to push too vigorously on these issues. In particular, many Executive Directors do not think they should be made conditions of IMF assistance. Some directors are uneasy about the distinction between productive and unproductive spending (perhaps where they represent countries with large military budgets). Despite these reservations (or perhaps reflecting gradual changes in attitudes within the Board), in late November 1993 the Board agreed that the successor to the current ESAF should give greater and more

systematic emphasis to the composition of social policies and public expenditure reviews.

The Fund's growing flexibility and initiative regarding social safety nets shows up clearly in the very recent series of Standby or ESAF arrangements with the West African Monetary Union (CFA) countries, as part of the multifaceted package of assistance accompanying unprecedented devaluations in those countries. In every case these arrangements provide that health and education spending (corrected for inflation) remain constant or increase. In addition, the agreements redesign tariffs or taxes to offset the impact of devaluation on basic consumer goods, including grains and flour, medicines, and kerosene. Temporary subsidies are part of some of the agreements. Social funds to finance small public works, often at the initiative of local governments or NGOs, are also part of the package. Cuts in government employment are linked to severance pay provisions and, in some cases, to modest wage increases focussed on lower-paid civil servants and industrial workers. In at least one case these are partly financed by deep cuts in special allowances for high officials.

The Fund has also begun to offer technical assistance in the redesign of social security and assistance systems. Specialized missions are sent in response to governments' requests. So far most of the missions have gone to former Communist countries.

ESAF -- or more precisely the Policy Framework Papers that are part of the ESAF process -- has encouraged co-operation between the Bank and the Fund, and in so doing has contributed to Fund staff sensitivity regarding poverty issues. The Fund attempts to draw a line between helping governments to buffer the social costs of stabilization measures, especially to poorer groups, and addressing more basic causes of widespread poverty. The latter is clearly a World Bank responsibility. The Fund's mandate to address short-run stability and balance of payments problems can clash with the Bank's mandate to address structural poverty as well as to promote growth more generally. For instance, Fund pressure for reduced deficits can lead governments to cut local budget support for investment projects sponsored by the Bank (or other donors). Under ESAF, the Bank and the Fund must collaborate with the borrowing government in drawing up a Policy Framework Paper that establishes broad goals and targets for the next three years. The papers are updated annually. Initially there was a good deal of friction between the Fund and the Bank regarding the details of the Policy Framework Papers for specific countries, reflecting their different priorities and perspectives. There is a consensus that this friction has dwindled, as staff on both sides of Nineteenth Street better understand and more automatically consider the other's concerns. That trend must contribute, at least modestly, to making IMF policy advice and requirements more sensitive to anti-poverty and growth considerations.

2.<u>Dialogue with governments about the Policy Framework Papers (PFPs) that are part of ESAF programs promote the learning that must underpin government "ownership" of reforms. Giving governments more responsibility for the PFPs would increase ownership.</u>

The importance of government "ownership" of reforms has become increasingly clear in the past decade. More than half of IMF programs in general (not only ESAF) break down before completion. Traditional stabilization programs mainly involve ministers of finance and central banker. While the key measures are politically difficult, they are administratively fairly simple to put in place. In contrast, many of the institutional reforms that are part of structural adjustment are more complex to put in place and administer. They require the understanding and active collaboration of many people in different agencies and ministries; therefore they require deeper and more widespread ownership.

The Policy Framework Papers associated with ESAF programs can help to strengthen government understanding and ownership of reforms. That assertion may seem paradoxical, since PFPs have mainly been prepared by the Fund in collaboration with the Bank, and discussed with governments only after the two Bretton Woods institutions had worked out their own disagreements. However, some governments are now taking the initiative in preparing the annual revisions. Moreover, even where Washington still does the drafting, the document and the discussions organized around it can promote ownership of the reforms. In some (not all) of the poorest countries, limited administrative capacity means that government officials rarely try to gather together the main aspects of economic policy, to assess their consistency and feasibility, and to frame programs for specific sectors within that context. The PFP may both press and assist them to do so. Fuller information and better understanding may not automatically produce agreement, but it improves the prospects for realistic and productive dialogue, and ultimately for fuller ownership.

PFPs not only deepen but also broaden understanding of reforms within the governments concerned. Traditionally, IMF missions talk almost exclusively with Ministry of Finance and Central Bank officials. Broader ESAF concerns have led IMF staff to broaden their contacts to include "line" ministries such as Agriculture or Education. Or the Minister of Finance may conduct a series of meetings with line ministers and the joint Fund/ Bank mission. In either case, line or operating ministries are pushed to consider their own programs and policies in the context of broader economic and financial constraints and targets. Communication between line and central economic agencies may be strengthened, and understanding of the economic program better diffused throughout the government. The contribution is not dramatic, but can be helpful.

Another aspect of new ESAFs may also bolster ownership. At the IMF Board meeting in late November last year, it was agreed to make more systematic and extensive use of internal contingency mechanisms in new ESAF agreements. As in other kinds of Fund programs, performance targets in ESAF agreements are designed on the basis of estimates regarding financial flows, including expected external financing from other donors and projected trade earnings and outlays. Contingency mechanisms provide some flexibility in case actual external financing or international prices are different from those anticipated. For instance, if external finance should fall short, in a particular quarter, an internal contingency provision might specify that the government could compensate, up to a stated sum, by internal borrowing during that quarter. The provision gives the government some flexibility to respond to changes beyond its control, without having to request a formal waiver of ESAF conditionality from the Fund. Since projections often turn out to be off the mark, greater use of contingency provisions increases the realism of the planning and negotiation process. Increased realism enhances commitment.

The ESAF process would contribute more to ownership if most governments took a greater role in putting together the Policy Framework Papers. Now that the basic procedures have been established and tested, both the IMF and the World Bank should be urged to encourage governments to take the initiative on PFPs. Some governments might need Fund and Bank staff seconded to assist them initially. But ownership will be more effectively encouraged by working with government officials on their home territory than by drafting a paper in Washington. The shift might also result in some unacceptably poor quality efforts. The Fund and Bank would have to insist that these be improved. In the course of the process, government analysts and officials would gain a better grasp of Fund and Bank reasoning; valid government objections to their prescriptions would also be sorted out from misunderstandings and poor analysis. The approach would be slower and would require more patience than the current pattern, and might not work where speedy action is essential. Nonetheless, it is the right direction in which to move.

3. <u>There are strong arguments for encouraging the IMF to release reports on Article IV consultations, with a time lag of six months or a year. However, requiring such action as a condition for release of U.S. funds for ESAF II is an inappropriate means to a valid goal.</u>

Fund reports on Article IV consultations include both staff analysis and recommendations, and background papers with information on countries' economic situations and prospects. Much of the empirical discussion appears (with a lag) in various Fund publications, including (since 1992) a series of annual "Economic Reviews" of individual countries (to date covering mainly the successor states to the former Soviet Union, but now being expanded

to include other countries). Within the last few weeks the Fund has started to release press statements that include not only past performance but also basic economic projections, drawn from Board papers.

What is not released are the Fund staff's analysis and recommendations. Opposition to release comes as much or more from the Executive Board as from the staff; member governments (including most of the industrial nations) prefer to keep their consultations with the IMF confidential. A strong argument can be made that IMF analysis and advice of the kind covered in Article IV consultations is an important addition to debate regarding economic policy. In democratic systems that debate should be open to the public. Disclosure might also help to demystify impressions among some parts of the public regarding Fund relations with governments.

However, particularly where a country faces fairly severe economic difficulties, immediate and full disclosure of Article IV consultations might well chill frank exchange, and might also intensify destabilizing pressures in some situations. Disclosure after a time lag should considerably ease those problems, at the cost of reduced relevance to public debate. (It may be worth noting that Letters of Intent submitted by a government in connection with a Standby Agreement and Policy Framework Papers are regarded as the property of the government and may be released at its discretion.)

Although I support the goal of disclosure, I do not think that requiring IMF compliance with U.S. demands for disclosure as a condition for release of funds to support ESAF II is an appropriate means. In effect, that approach holds the poorest countries in the world, at moments when they most need external support, hostage to the concurrence of Executive Directors who mainly represent entirely different countries and concerns. Since the current U.S. administration is strongly committed to disclosure, it should pursue that goal by force of persuasion, rather than at the expense of the poorest.

Testimony of

Professor Jeffrey D. Sachs
Harvard University

April 19, 1994

to the

Subcomittee on International Development, Finance, Trade and Monetary Policy

of the

Commitee on Banking, Finance and Urban Affairs

Mr. Chairman and members of the Subcommittee, thank you very much for the opportunity to testify regarding the Administration's request for a $100 million contribution to the IMF's Enhanced Structural Adjustment Facility (ESAF) program. Since 1987, the ESAF program has been a valuable tool for supporting economic reform and recovery in the poorest nations. It has a successful track record in many countries, though not in as many as it might. Moreover, the proposed $100 million contribution is part of a multilateral effort already subscribed to by more than three dozen countries, so that the overall ESAF program will be able to extend loans of more than $5 billion, to the poorest countries of the world.

For these reasons, I strongly support the proposed extension of the ESAF and the U.S. contribution. But I do not support that extension unconditionally or at this time. The U.S. contribution should be delayed until the IMF management and Executive Board create conditions to ensure the more effective utilization of replenished ESAF resources.

The IMF fails to abide by one of the most basic American beliefs about good governance: the need for openness and accountability in official institutions. The IMF is probably the most secretive international institution outside of the military and security areas. <u>All of its operational documents, including all loan agreements, policy recommendations to member governments, and even the annual reviews of member-country economies (so-called Article IV consultations), are confidential, and are not available for public scrutiny</u>. Moreover, this confidentiality is without expiration date. As far as I know, the IMF has not released any operational documents previously characterized as confidential since the inception of the institution, in 1946.

It is easy to be misled by IMF procedures regarding

publication of documents. The IMF supplies voluminous materials to the public, including valuable data on member-country economies. It also publishes general analyses of the economic developments in several of its member countries. This documentation does not, however, describe the IMF's detailed advice concerning economic policies, nor the terms under which IMF loans are made available, nor the detailed results of IMF programs. The IMF tends to issue studies on "successful" cases but not on unsuccessful cases where its own advice should be subjected to scrutiny.

The work of the IMF staff is, of course, subject to the approval of the Executive Board of Directors, constituted by Finance Ministry officials of a subset of member countries. It is also the case that an individual congressman can peruse IMF documents through the U.S. Executive Director's office. But this is an insufficient basis for oversight. There is no public availability of key information in the countries undertaking economic reforms, nor in the donor countries, nor in the professional communities of economists, bankers, investment analysts, political scientists, development aid specialists, and others that have extensive professional knowledge of the countries in question.

The IMF's secrecy has at least two sources. Formally, the IMF operates under the mandate of the Executive Board. Many member governments resist the publication of information concerning their own economies. Many members have no tradition or inclination to release public information about their economic policies. The IMF management and staff have pointed out that the IMF receives information on a confidential basis from member countries, and so must keep that information confidential unless the Executive Board deems that other procedures are appropriate. At the same time, the IMF staff is eager to preserve the secrecy of the institution. The secrecy lessens public scrutiny and insulates the staff from accountability. While it is true that the current secrecy reflects the decisions of many countries and not just the IMF management, there is no reason why the U.S. should simply abide by these decisions, or should be prepared to appropriate funds for the ESAF under current procedures.

In my professional judgement, IMF secrecy has had serious adverse consequences for the design and implementation of IMF programs, including ESAF programs. As economic advisor to more than one dozen governments that have had extensive dealings with the IMF, I have found the quality of IMF recommendations and program design to be uneven, and in many cases to fall below best professional practices. Even when the <u>general</u> direction of IMF advice is salutary, as it usually is, the specific content of that advice is often flawed, leading to program failures that could and should have been avoided.

There is no realistic possibility under current circumstances

for public scrutiny to help correct these shortcomings. According to IMF public relations, all economic success stories are partly the result of good IMF advice, and all economic failures are due to shortcomings in the reforming country, but never to the IMF recommendations. I know from personal experience, however, that many economic successes resulted from measures that were initially vehemently opposed by the IMF; and many failures came because of flaws in the design and timing of IMF programs. Nonetheless, without the written record, there is no realistic way to have a serious public debate on the key issues, nor to bring public pressure to bear to correct the flaws in IMF programs.[1]

I have recently had several difficult experiences as a result of this secrecy. I have recently prepared a study and critique of IMF policies in Russia, for an annual World Bank conference that will take place later this month. Despite the urgency of the issues involved, I was not allowed to quote from IMF documents in the presentation of my arguments. This is like having a debate with a phantom. Last year, at the invitation of the Kyrgyz President, I offered a written critique of IMF policies in Kyrgyzstan. The IMF subseqently applied informal pressure to key members of the Kyrgyzstan Government to stop "complicating" matters by having more than one source of macroeconomic advice.

Let me summarize the kinds of technical issues that arise in the preparation of an ESAF program. When an IMF member government is in financial distress, and appeals to the IMF for a loan, the IMF must make several important judgements, of the following sort:

(1) In meeting the financial crisis, what should be the relative weights given to budget cutting, foreign financial flows, and debt reduction?

(2) What should be the timing and use of the IMF's own resources as part of the overall assistance package?

(3) What kind of exchange rate arrangements should the IMF recommend (in fact, require): a floating exchange rate, a crawling peg exchange rate, or a fixed exchange rate?

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[1]I will cite one example of pressing relevance. The IMF initially opposed the early introduction of the Estonia currency, and the use of a currency-board arrangement for the Estonian Central Bank. The Estonians decided to proceed anyway, and at the last moment, the IMF decided to support the effort. Later on, the IMF has basked in the acclaim of the Estonian monetary reforms, which had gone ahead despite its opposition. Currently, several other countries in the Former Soviet Union, such as Kyrgyzstan, would like to explore the feasibility of a similar currency-board arrangement, but are strongly advised by the IMF not to proceed in that way.

(4) What kind of institutional reforms should be recommended, and perhaps required, as a condition of the lending: central bank independence, budgetary reform, and so forth?

In my view, the IMF makes systematic and repeated mistakes on these delicate questions. Most importantly, the IMF puts too much weight on budget cutting, and not enough on foreign assistance and debt relief as mechanisms for addressing the acute phases of a financial crisis. The IMF often limits the availability and use of its own funds to the point of rendering the IMF loan itself little more than window dressing.[2] There is too much IMF reliance on floating exchange rates, and not enough use of pegged exchange rate (crawling or fixed) as a key "nominal anchor" in stabilization programs. The IMF generally pays insufficient attention to institutional reform, such as central bank independence or currency-board arrangements for smaller countries.[3]

The case for greater public disclosure rests on three legs. First, it would raise the chances for well-functioning IMF programs, by bringing to bear public and professional scrutiny and debate on IMF analyses. Second, it would enhance Congress's and the public's ability to oversee the use of funds appropriated for the ESAF program. Other than the U.S. Treasury itself, there is no General Accounting Office, Congressional Budget Office, or independent watchdog groups that provide independent checks on the use of the funds. Therefore, it is extremely important that the program's documents be made publicly available.

Third, and equally important, greater IMF openness would improve the political accountability and democratic functioning of the member governments that seek to draw upon IMF resources. Some of the least democratic governments in the world have been regular users of IMF funds, including ESAF funds. These governments agree to take actions that involve the most basic welfare of their citizens, and yet do not involve their own citizenry in the formulation and debate over these measures. Moreover, the IMF encourages this secrecy, even years after IMF agreements have been put in place. We should be pushing, indeed requiring, countries that want to draw on IMF funds to be more open about their policies

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[2]In the IMF's loan to Russia in the summer of 1992, for example, the IMF made available $1 billion, but under the condition that the money be held in the bank as reserves, and not actually be used.

[3]Despite the success of Estonia's currency board, the IMF has aggressively rejected a similar arrangement in Kyrgyzstan and in Mongolia, two countries where I have advised. The IMF also gave deeply flawed advice to Russia and the other CIS states in 1992 to maintain a common currency, despite the profound inflationary consequences, which were predictable and predicted.

to their own citizens as a condition for the privilege of using U.S. taxpayer dollars.

The U.S. Treasury has recently suggested that IMF loan documents are too sensitive to be released to the public. I would strongly reject this claim. The kind of information that is in an IMF agreement is almost always available in democratic countries in any case, and should be automatically available in all countries. It is true that some information is too sensitive to be released immediately, such as information on exchange rate and interest rate policy decisions to be carried out in future weeks. Moreover, sensitive negotiations may need to be pursued outside of the public glare, before agreements on controversial policy measures are reached. For these reasons, there is a plausible case for allowing a delay on the required release of IMF loan documents for a few months -- perhaps 6 months -- so that negotiations can be completed and "prior actions" in the financial markets can be undertaken. Governments may of course choose to release the documents earlier, and in most cases should.

In our own country, the Federal Reserve Board has found ways to reconcile the need for operational secrecy at the moment of decision-making with the equally pressing need for public scrutiny of those decisions, through the release of the minutes of FOMC meetings with a delay of six weeks, and through the Congressional oversight of Federal Reserve policy. That kind of pragmatic compromise makes vastly more sense than the blanket assertion that IMF loan documents deal with materials "too sensitive" for the public view.

Recommendations

The Administration's request for $100 million for the ESAF program should be supported vigorously as soon as the IMF makes the necessary changes to open the institution to public scrutiny. The U.S. Treasury should play a far more active role than until now in pressing for greater openness and accountability of the IMF. I would recommend the following steps.

(1) In order to establish the historical record of IMF activities -- for economists, historians, policy analysts, politicians, and other interested parties -- all documents that were reviewed by the Executive Board before January 1, 1989, and including all loan agreements, should be made available to the general public. A general policy should be established to make available all such documentation on a routine basis with a lag of 5 years.

(2) With regard to new loan agreements from this point forward, all loan documentation reviewed by the Executive Board should be made available to the general public within 6 months of the loan approval by the Executive Board. This documentation would include

the formal Request for Purchase; the Staff Appraisal; the Letter of Intent; the text of the Purchase agreement itself; and other relevant documentation as might be presented to the Executive Board in connection with the loan. If there are urgent and specific reasons for not releasing a document, the member country could appeal to the Executive Board to vote a waiver, which would delay the release of the documents for an additional fixed period of time, perhaps an additional 6 months. Note that previous loans agreed to after January 1, 1989 and before the start of this new policy would remain confidential for the five-year waiting period.

(3) Other standard documentation reviewed by the Executive Board (Recent Economic Developments [REDs], Article IV consultations, policy framework papers, etc.) should also be released to the public within six months of review by the Executive Board. It is important to stress, however, that the key operational documents are related to loan agreements, and these are the documents for which public scrutiny and debate are most critical. Attempts to "open" the IMF by the release of the less-operational documents (e.g. Article IV consultations) would not be sufficient.

(4) The IMF should create an Independent Advisory Board composed of distinguished bankers, political scientists, economists, and former government officials with relevant experience, to act as an advisory body concerning the design and implementation of IMF programs. This IAB would make recommendations and comments to the Executive Board; commission independent studies and analyses on key issues (e.g. the design of exchange rate policies in the course of stabilization); and be available to member governments seeking an independent professional opinion on a central point of program design. The IAB could also be vested with more formal authority as a kind of independent review panel that would make recommendations to the Executive Board vis-a-vis the design and implementation of IMF lending programs.

(5) The U.S. should propose other mechanisms for increasing the scrutiny of IMF programs. For example, the IMF Executive Board should commission independent teams of experts to make recommendations in particular countries, with these recommendations put before the Executive Board, together with or in lieu of internal staff recommendations. Moreover, member countries should be encouraged, and given the formal opportunity, to invite independent teams of experts to submit recommendations to the Executive Board.

(6) As the U.S. might not be able to prevail upon other IMF member countries to support this new standard of openness, it might be necessary to instruct the U.S. Excutive Director to vote against loans to countries that decline to comply with the requirement for public disclosure. Moreover, the U.S. Treasury should be directed to report to the Congress on progress in establishing the new disclosure regulations. The Congress can wait to authorize and

appropriate the ESAF funds until adequate disclosure policies of the U.S. Government and the IMF have been agreed.

(7) The U.S. Treasury should also be instructed to explore new ways, in the longer term, to mobilize financial support for member countries in crisis by tapping the <u>private capital markets</u>, rather than taxpayer-supported loans. For example, in analogy with companies in Chapter 11 bankruptcy, member countries in crisis might be given the opportunity to borrow from the private sector on a <u>priority basis</u>, so that the country's new creditors would be placed first in line for repayment, ahead of existing creditors. (Such debtor-in-possession financing with administrative priority, is typical in Chapter 11 bankruptcy, and is covered in the U.S. Bankruptcy Code, Chapter 11, § 364). Such an approach could trigger billions of dollars of private financial flows to financially distressed economies. There are several legal and policy complexities that would have to be sorted out in order to move forward on this kind of approach (e.g. whether to establish the approach through treaty, or policy of the IMF Executive Board, or other means), but the general direction is promising enough to merit the effort.

OPENING STATEMENT

OF

Nguyuru H. I. Lipumba

before the

SUBCOMMITTEE ON INTERNATIONAL DEVELOPMENT,
FINANCE, TRADE AND MONETARY POLICY

OF

HOUSE COMMITTEE ON BANKING, FINANCE, AND URBAN AFFAIRS

regarding

"The International Monetary Fund and the Administration's Request for Authorization the US Contribution to the Enhanced Structural Adjustment Facility."

I have five points to make on the IMF policies and the developing countries particularly those of sub-saharan Africa.

1. Openness and Transparency

To improve the quality of policy design and implementation, adjustment and stabilization policies that the IMF expects African Governments to implement as part of the loan agreement should in general be made available to the public particularly the parliaments of these countries. The IMF and the World Bank do not have a monopoly of wisdom about appropriate stabilization, adjustment and development policies. Mistakes of wrong design and sequencing of reforms could be avoided by promoting open discussion of adjustment and stabilization policies by analysts outside these institutions. In general the IMF should adopt an open policy of "no objection to the release of policy documents" and encourage

Governments to release these documents to the public. Effective implementation of policies requires conviction by those who implement policies and public support for the reform strategy. If governments are afraid or unwilling to explain these policies to their own people, how can they build and sustain public support? Transparency and Openness is necessary for building political consensus.

2. IMF stabilization policies have not established the pre-requisite for promoting medium and long term growth.

To promote growth on a sustainable basis requires public expenditures on human resources particularly education and health, and investment in infrastructure. Stabilization policies have tended to emphasize large expenditure reductions that have fallen on social sectors while tax evasion by the rich has been allowed to continue. Servicing external debt is taking an increasingly large share of government revenue. Large external debt reductions are necessary to reduce budget deficits. Fiscal policies under structural adjustment should prioritized expenditures on primary health care particularly preventive medicine, education and investment in infrastructure. The IMF, the World Bank and the recipient country should also utilize the expertise of agencies such as UNICEF that have long experience on appropriate policies for the social sectors.

3. The World Bank should take the lead in advising countries on Adjustment Policies.

The IMF does not have a technical comparative advantage in designing medium and long term development programs that can establish a sustainable export capacity that will alleviate the balance of payments crisis in the medium term. The World Bank should take the lead in discussing and advising countries that are eligible to use ESAF resources. Closer cooperation and coordination of the IMF and the World Bank with the recipient country is required beyond the drafting of the policy framework papers to include the setting and reviewing of performance tests. The traditional IMF performance tests of quarterly credit ceilings may appear to be technically objective and relatively easy to monitor but may not be relevant to the improvement of the balance of payments and restoring growth. Annual review of the overall performance of the economy is a more realistic approach. Improvement in the collection of information on a quarterly basis should continue which will allow policy makers and other analysts to determine whether their policies are on track and are achieving desired results. However, quarterly and semi-annual performance criteria are unrealistic for economies dependent on the agricultural sector.

4. More Resources should be allocated to Sub-Saharan Africa.

Since 1984, Sub-Saharan Africa, poorest region in the World, has in each year repaid more money than it has received from the IMF. Many African countries are implementing far reaching economic reforms. The IMF should be required to allocate a larger proportion of the enlarged ESAF to Sub-Saharan African countries and attain a significant positive net resource inflow to this region.

5. Ownership of the Reform Process

African Governments should play a leading role in designing adjustment programs rather than simply signing a letter of intent to the managing director of the IMF drafted by the IMF staff. Governments should explain their policies rather than react to policies proposed by the IMF staff. The "letter of intent" explaining government policies should be drafted by governments seeking IMF financial assistance. This will encourage governments to employ technically competent people who can effectively negotiate with the Fund and defend the policies to attain consensus within the country. Many stabilization programs have collapsed because they have been imposed by the IMF and lack domestic ownership. The process of designing reforms would be changed and the IMF should be reacting to policy initiatives of African countries rather than the other way around. This process will be promoted by more openness, transparency and discussion of adjustment policies and reform within African countries.

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